Petition

81-680

No. 81-.....

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

HERMAN & MACLEAN

Petitioner,

v.

RALPH E. HUDDLESTON AND CHESTER E. BRADLEY,
individually and as class representatives

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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October 8, 1981

QUESTION PRESENTED

Does an implied remedy exist under either § 10(b) of the Securities Exchange Act of 1934 or § 17(a) of the Securities Act of 1933 for purchasers of securities who have an express remedy under § 11 of the Securities Act of 1933 by virtue of the fact that the securities purchased were issued pursuant to a registration statement filed as required by § 5 of the Securities Act of 1933.

PARTIES BELOW

Plaintiffs — appellees in the Court of Appeals were Ralph E. Huddleston and Chester E. Bradley, Jr., individually and as designated class representatives of a class consisting of purchasers of securities of Texas International Speedway, Inc. during a ninety day period commencing with the effective date of a registration statement pursuant to which such securities were issued. The defendants — appellants were Lawrence A. Lopatin, Leslie Share, and Herman & MacLean, certified public accountants.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

OPINIONS BELOW

The opinion of the Court of Appeals (Wisdom, Rubin, Sam D. Johnson, J.J.) is reported at 640 F.2d 534 (5th Cir. 1981) and is set forth in the Appendix beginning at page A-1. The opinion of the Court of Appeals issued in connection with the denial of the petition for rehearing and suggestion for rehearing en banc is reported at 650 F.2d 815 and is set forth in the Appendix beginning at page B-1. The District Court (Taylor, J.) did not issue an opinion, but the final judgment of the District Court, as amended, (without the exhibits attached thereto pertaining to the computation of damages) is set forth in the Appendix beginning at page C-1.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1981. Plaintiffs—appellees timely filed a petition for rehearing and suggestion for rehearing *en banc*. On July 13, 1981, the petition was denied, with no member of the panel voting to grant the petition and with no Judge of Unit A of the Administrative Unit of the Fifth Circuit requesting that the Court be polled on rehearing *en banc*. This petition is filed within 90 days of that denial. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1976).

STATUTORY PROVISIONS

The text of Sections 4, 5, 11, 12, 13, and 17 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. §§ 77d, 77e, 77k, 77l, 77m and 77q (1976), and Sections 10, 18, 21(e) and 28(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78j, 78r, 78u(e) and 78bb(a) (1976), are set forth in the Appendix beginning at page D-1.

STATEMENT OF THE CASE

Texas International Speedway, Inc. ("T.I.S.") was organized in January, 1969, to build and operate an automobile racetrack in College Station, Texas. On June 17, 1969, T.I.S. filed a registration statement pursuant to Section 5 of the 1933 Act for the purpose of registering 3,300 units of securities, each unit consisting of a debenture in the principal amount of $1,000 and 100 shares of T.I.S. common stock. After a series of amendments, the registration statement became effective on October 30, 1969. The offering was underwritten on a firm commitment basis by a group of underwriters represented by Ladenburg, Thalmann, & Co. The closing of the underwriting occurred on November 7, 1969, when the managing underwriter delivered to T.I.S.

the proceeds from the public sale of T.I.S. securities. The Texas track was completed and placed in operation concurrently with the public offering, and races were held at the T.I.S. facility on November 9, and on December 7, 1969.

The operations of T.I.S. were not successful and on November 30, 1970, T.I.S. filed a petition for bankruptcy under Chapter X of the Bankruptcy Act. On August 25, 1972, a class action was filed in the Southern District of Texas, Houston Division, on behalf of persons claiming to represent the purchasers of the securities sold in the public offering. Although the plaintiffs were persons for whose benefit Congress has fashioned an express remedy in § 11 of the 1933 Act, no cause of action under § 11 was alleged. Instead, the plaintiffs alleged as a federal cause of action only an implied remedy under § 17(a) of the 1933 Act, § 10(b) of the 1934 Act and Rule 10b-5 of the Securities and Exchange Commission thereunder, 17 C.F.R. 740.10b-5.[1] Although there was no discussion below concerning limitations as affecting the availability of a § 11 remedy, the elapse of almost twenty-one months between the filing by T.I.S. of a bankruptcy petition and the filing by the plaintiffs of their lawsuit creates at least a reasonable inference

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[1] Although the plaintiffs alleged violations of § 17(a) in their original complaint, the court below did not deal separately with § 17(a). As discussed *infra*, the implication of a private remedy from § 17(a) where an express remedy under the 1933 Act is available has been recognized by this Court as an unresolved issue. Petitioner suggests that an added reason for the granting of certiorari in this case is that it would afford the Court the opportunity to consider the availability of an implied remedy under either § 10(b) or § 17(a) when express remedies under the 1933 Act are provided for the same conduct. The plaintiffs also alleged a violation of the Texas Securities Act, Article 581-33(A)(2), Tex. Rev. Civ. Stat. (Supp. 1963). The Court of Appeals found that none of the defendants were "sellers" for purposes of the Texas Securities Act and reversed the district court's finding of liability on this point.

that the plaintiffs correctly believed in August 1972 that an action under § 11 would be time barred.[2]

The plaintiffs sued almost the entire array of participants in the T.I.S. offering. The only exceptions were T.I.S. itself, presumably because it was regarded as judgment proof, and the attorneys who had represented T.I.S. in the offering. The persons sued included the former directors and principal officers of T.I.S., Ladenburg, Thalmann & Co. and the other members of the underwriting group, the attorneys for the underwriters, the accountants for T.I.S., the firm of consulting engineers which gave an opinion in the T.I.S. prospectus as to the estimated costs of construction of the racetrack, and the principal contractor for construction of the facility. Some of the persons sued were within the class of persons against whom § 11 of the 1933 Act provides a remedy, and others of the persons sued, such as the attorneys for the underwriters and the contractor, were persons against whom § 11 does not provide a remedy.

As is not unusual in these cases, the issue of class certification was hotly contested. One of the principal contentions of the defendants was that the class should, in any event, be limited to persons who were entitled to the prospectus. See *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* 482 F.2d 880, 882 (5th Cir., 1973), holding that a condition to certification in Rule 10b-5 actions is that each member of the class have been furnished essentially the same information. To accommodate this requirement, the district court limited the class in this lawsuit to persons who purchased T.I.S. securities within a period of ninety days after the effective date of the registration statement. The significance

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[2] Section 13 of the 1933 Act requires that any action to enforce a liability arising under §11 be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made in the exercise of due diligence."

of the ninety day period is that under § 4(3) of the 1933 Act the availability of an exemption for dealers in registered public offerings of securities not previously registered is conditioned upon the delivery by such dealers of a prospectus to each person purchasing the security within such ninety day period. Accordingly, the class was defined by the district court to include only persons entitled to receive a prospectus.[3]

After a series of settlements had removed the underwriters, the attorneys for the underwriters, and the contractor as defendants, the lawsuit was finally tried to a jury in the summer of 1979. Special interrogatories were submitted to the jury and, based on the findings made by the jury, the district court entered judgment against two of the former directors and principal officers of T.I.S. and against the accountants.

THE COURT OF APPEALS' OPINION

The opinion of the Court of Appeals characterizes the case presented to it as one which "traverses the gamut of Rule 10b-5 issues." (App. A-1). The court reversed the judgment of the district court and remanded for new trial because of, among other things, evidentiary errors, the refusal by the district court to submit special interrogatories on the issues of reliance and causation, and the method used by the district court to determine damages.

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[3] The court below stated that § 4(3) requires that a prospectus be "kept effective" for a ninety-day period and that Rule 10b-5 requires that the registration statement be accurate during the period that dealers are required to deliver a prospectus. (App. A-3, n.1). It is not clear whether the court below intended the negative pregnant that Rule 10b-5 does not require the accuracy of prospectuses used after the dealer delivery requirements have expired. Presumably, it did not. The court's confusion is again caused by its superimposition of Rule 10b-5 concepts onto the structure of the registration provisions of the 1933 Act.

The Court of Appeals did not, however, find for the defendants on either of the issues which would have required rendition: the absence of credible evidence to support jury findings of scienter and the absence of an implied remedy under either § 10(b) of the 1934 Act or § 17(a) of the 1933 Act for this action in which the plaintiffs had an express remedy under § 11 of the 1933 Act.

The Court of Appeals was persuaded to find an implied remedy under § 10(b) despite the existence of an express remedy under § 11 for the same conduct on the basis of three lines of authority. First, the court relied on the holding in *Fischman v. Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951) that § 10(b) should be held to co-exist with § 11 because §10(b) requires proof of fraudulent conduct and § 11 does not. (App. A-7). Although the court below noted that the *Fischman* decision is distinguishable because it finds a § 10(b) remedy to exist for the benefit of purchasers who had no remedy under § 11, nevertheless, the court reiterated with approval the *Fischman* rationale, *i.e.*, that the trade-off of requiring the plaintiff to establish scienter against the elimination of the procedural safeguards benefiting the defendants is fair to the parties.[4]

Secondly, the court below relied upon language from this Court's holding in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969) that in considering the authority of the Securities and Exchange Commission to obtain injunctive relief

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[4] Whether the test for implying a remedy is the four-part test of *Cort v. Ash*, 422 U.S. 66 (1975) or is confined to determining whether Congress intended to create a private right of action, the opinion of the court as to the fairness to the parties of creating an implied remedy is clearly an inappropriate standard. Yet, as the court below noted, the *Fischman* test has been accepted by the lower federal courts and the commentators alike as the classic reconciliation of the conflict between § 10(b) and § 11. (App. A-7). *See also*, Mr. Justice White's majority opinion and Mr. Justice Rehnquist's opinion concurring in the judgment in *California v. Sierra Club*, ___ U.S. ___, 101 S.Ct. 1775 (1981).

from the courts under the aegis of § 21(e) and § 10(b) of the 1934 Act, the fact that the alleged fraud occurs within the context of a proxy solicitation does not preclude the Commission from acting. In reaching the result, this Court observed that ". . . the fact that there may well be some overlap is neither unusual nor unfortunate." 393 U.S. at 468. The court below quoted this language with emphasis as indicating that the existence of an express remedy under § 11 should not affect the availability of § 10(b) (App. A-8).[5]

Finally, the court was persuaded by the argument advanced in *Ross v. A. H. Robins Co.*, 607 F.2d 545 (2d Cir. 1979) *cert. den.* 446 U.S. 946 (1980) that to deny the protection of § 10(b) would "encourage corporate managers to include these misrepresentations in material filed with the S.E.C. for the sole purpose of insulating themselves from liability under § 10(b) and restricting the class of potential plaintiffs to the unlikely few who actually viewed and relied on the misleading information." 607 F.2d at 556 (App. A-10).[6]

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[5] Several things should be noted about the precedential value to this case of the *National Securities* decision. First, the Commission in *National Securities* was acting pursuant to the authority expressly granted in § 21(e) of the 1934 Act; therefore, there was no implied remedy issue. Secondly, there was in fact no "overlap" in *National Securities* because the defendant's proxy solicitation was not governed by § 14(a) of the 1934 Act or the Commission's proxy rules. Further, this Court observed in *National Securities* that the case presented "none of the complications which may arise in determining who, if anyone, may bring private actions under § 10(b) and Rule 10b-5." 393 U.S. at 467 n.9.

[6] The decision in *Ross* reflects a concern that the reliance requirement of § 18 not preclude recovery by plaintiffs who are not required by § 10(b) to establish reliance. This rationale seems misplaced in the present case, since the plaintiffs, had they preserved their § 11 remedy, might have recovered without demonstrating reliance and the court below held that the plaintiffs must prove reliance in order to recover under § 10(b). To compound its confusion the court below equated a filing under

REASONS FOR GRANTING THE WRIT

The precise issue here presented — whether an action made a violation of the 1933 Act for which an express remedy is provided may serve as the basis for an implied action under § 10(b) of the 1934 Act — is one which the Court has previously recognized as undecided and left open for consideration in a proper case. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 752 n. 15 (1975). This Court has also recognized and left open the similar but more limited issue presented by the relationship between § 10(b) and § 18 of the 1934 Act. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 211 n. 31 (1976). Finally, this Court in *Blue Chip Stamps* left undecided the question whether a remedy should be implied from the language of § 17(a) of the 1933 Act, from which Rule 10b-5 was fashioned, "in light of the express civil remedies of the 1933 Act." 421 U.S. at 733 n. 6.

The merits of the issue here presented as well as the reasons why the Court should consider the issue have recently been fully presented to the Court in petitions for writ filed on behalf of certain of the defendants in *Wachovia Bank and Trust Co. v. National Student Marketing Corp.* 650 F.2d 342 (D.C. App. 1980) *cert. den.* 49 U.S.L.W. 3931 (June 15, 1981). See Petitions for Writ of Certiorari Nos. 80-1684 and 80-1691. The *Wachovia Bank* case did not, however, present a compelling factual basis for the Court's determination of the issue, since in that case the plaintiffs were persons for whose benefit a cause of action under

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the 1934 Act, in which a misrepresentation or omission could well go unnoticed because shareholders and prospective purchasers do not in the ordinary course of affairs see those filings, with a prospectus used in public offerings, which purchasers are likely to see. The class was here limited specifically to those persons entitled by § 4(3) of the 1933 Act to receive a prospectus as a condition to the exemption for the dealers selling the securities.

§ 11 never arose. The argument was there made that although by giving investment representations the plaintiffs had "waived" a § 11 remedy, the conflict between § 11 and § 10(b) was nevertheless preserved for consideration. Here the plaintiffs had a § 11 remedy which they permitted to become time barred.[7]

By electing to sue under § 10(b), the plaintiffs were enabled, among other things, to avoid the limitations period prescribed in § 13 of the 1933 Act, to include as defendants persons against whom Congress provided no remedy under § 11[8], to assert grounds for liability as to the "expert" defendants not encompassed by § 11[9], and to avoid the possibility that the district court might require an undertaking for costs pursuant to § 11(e).

It is submitted that the clearest presentation in the federal securities laws of the implied versus express remedy

[7] The court below observed that the plaintiffs here "apparently did have a Section 11 remedy." (App. A-7 n.5). Petitioner is not aware of any basis for doubting that plaintiffs had a § 11 remedy which they failed to pursue.

[8] As pointed out earlier, the plaintiffs joined as defendants the attorneys for the underwriters and the contractor for construction of the racetrack. Both of these parties settled before trial and the amounts received in settlement aided the plaintiffs in financing the litigation as to the nonsettling defendants. (App. A-3). This Court has previously observed that the vexatiousness of § 10(b) litigation is different in degree and in kind from that of other litigation. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975)

[9] Section 11(a)(4) provides that an "expert," such as an accountant, engineer, or appraiser may be sued by the purchaser of a registered security "with respect to the statement, report, or valuation, which purports to have been prepared or certified by him." The accountants in this case were sued generally as participants in the securities offering, and liability was asserted against them in part on the basis of alleged misrepresentations or omissions in materials not "expertized" by them. This Court has previously raised the issue whether, even in an action not

issue occurs where, as here, § 11 of the 1933 Act is implicated. Section 11 is a paradigm of exactitude. When combined with the limitations provisions of § 13, it is sufficient for the disposition of every substantive issue which is apt to be presented. It specifies who may sue, the degree of knowledge of the matters misrepresented or omitted which will bar the plaintiff from recovery, the class of persons who may be sued, the extent to which participation by experts may subject them to liability, the circumstances under which the plaintiff must establish reliance and when reliance is required how it is to be established, the defenses available to defendants, the measure of damages, the basis for requiring an undertaking for costs, the grounds for assessing costs, and the basis for and extent of liability for contribution among persons who were found liable or who if sued might have been found liable. Each of these issues, when presented in the context of § 10(b) claims, has been the subject of judicial determination on an ad hoc and frequently inconsistent basis. Participants in the process of raising funds through registered offerings of securities are entitled to know in advance the grounds for their possible liability.[10] The Court should therefore grant certiorari in order to dispose of this issue.

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subject to § 11, participation as an alleged "aidor and abettor" is a sufficient basis for liability under § 10(b), *Ernst & Ernst v. Hochfelder*, 425 U.S. at 191 n. 7. The court below characterized the plaintiffs' lawsuit as alleging a conspiracy among the defendants to violate § 10(b). (App. A-2) This characterization, which is unsupported by the pleadings or by the special interrogatories submitted to the jury, may have influenced the court's consideration of the scienter issue, and in any event it indicates the difficulties in analysis which arise when the courts depart from the precise standards for liability enunciated in § 11. *Cf. Epprecht v. Delaware Valley Machinery*, 407 F.Supp. 315, 320 (E.D. Pa. 1976).

[10] For an illustration of the confusion which can arise and the hardships visited on defendants when § 11 and § 10(b) claims are asserted simultaneously, *see Beecher v. Able*, 435 F.Supp. 397 (S.D.N.Y. 1977).

The lower courts, including the court below, continue to treat § 10(b) as an exception to the standards established by this Court in its recent decisions dealing with the existence and dimensions of implied private causes of action. Thus, the court below predicated its holding on what it described as the "classic reconciliation of the apparent overlap of the express civil liability provisions of the 1933 Act and the cause of action implied in Rule 10b-5 . . ." (App. A-7). That reconciliation is simply the determination made by Judge Frank in *Fischman* that a remedy should be implied because the procedural safeguards forfeited to the defendants are adequately counterbalanced by the requirement that the plaintiff prove scienter. 188 F.2d at 786-87. The *Fischman* court also supports its implication of a § 10(b) remedy by an elaborate example in which, the court concludes, the purchasers of securities assumed to have been fraudulently issued would be left without a remedy under the statute. 188 F.2d at 787. Aside from the fact that this conclusion overlooks the express remedies available under § 12(1) and § 12(2) of the 1933 Act,[11] the court's reasoning assumes it to be the proper function of the federal courts to find implied remedies where necessary to fill out the statutory scheme. This view of the authority of the federal courts has been emphatically rejected by this Court in *Touche Ross v. Redington* 442 U.S. 560, at 579 (1979) when it stated that:

> [W]e are not at liberty to legislate. If there is to be a federal damages remedy under these circumstances,

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[11] Judge Frank appears to have assumed for purposes of his analysis that the registration requirements of the 1933 Act are inapplicable to sales by "insiders" rather by issuers. This is clearly not the case. See the definition of "issuer" contained in the last grammatical sentence of § 2(11) of the 1933 Act, 15 U.S.C. § 77b(11). Further, Judge Frank appears not to have adverted to the fact that the defrauded purchasers in his example would, in any event, have a §12(2) remedy against the sellers.

> Congress must provide it. '[I]t is not for us to fill any *hiatus* Congress has left is this area.'

The most serious problem with the decision below is, however, its failure to heed the repeated teachings of this Court on implied remedies in those instances where express remedies are provided by Congress for the same conduct. In none of those cases in which this Court has recognized an implied § 10(b) remedy was there an express remedy available under the federal securities laws.[12]

In *Blue Chip Stamps*, the Court acknowledged that where an express remedy is provided the Court should be reluctant to find for the same conduct a more expansive implied cause of action:

> It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action [under § 10(b)] beyond the bounds it deliniated for comparable express causes of action.

421 U.S. at 736.

Similarly, in *Touche Ross*, 442 U.S. at 574:

> [W]e are extremely reluctant to imply a cause of action . . . that is significantly broader than the remedy that Congress chose to provide.

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[12] *Superintendent of Ins. v. Bankers Life and Cas. Co.*, 404 U.S. 6 (1971); *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). *Cf. Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), where the Court acknowledged the viability of an implied remedy under circumstances different from those there presented. Further, this Court has recognized that its § 10(b) holdings represent exceptions to its usual treatment of implied remedies explainable by a long history of lower federal court holdings commencing with *Kardon v. National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946). In fact, this Court has characterized its holdings as acquiescences. *Cannon v. University of Chicago*, 441 U.S. 677, 690 n. 13 (1979).

In *Transamerica Mortgage Investors, Inc. v. Lewis*, 444 U.S. 11 (1979), the Court, quoting *Touche Ross*, observed that ". . . when Congress wish to provide a private damages remedy, it knew how to do so and did so expressly," 444 U.S. at 21, and then held that:

> [I]t is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it. 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.' . . . See *Amtrak*, 414 U.S., at 458; *Securities Investor Protections Corp. v. Barbour*, 421 U.S. 412, 419; *T.I.M.E., Inc. v. United States*, 359 U.S. 464, 471.

444 U.S. at 19-20.

To the same effect, *Kissinger v. Reporters Committee*, 445 U.S. 136, 148-449 (1980):

> The Records Act also expressly provides administrative remedies for violations of the duties it imposes, implicating our conclusion in *Transamerica Mortgage* that it is 'an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it.'

There is no more elaborately conceived legislative scheme for express private damages actions in the federal securities laws than that provided by § 11 of the 1933 Act. This circumstance alone argues persuasively against the finding of an implied remedy in the present case, for, as stated in *Northwest Airlines, Inc. v. Transport Workers Union*, — U.S. —, 101 S.Ct. 1571, 1584, (1981):

> The presumption that a remedy was deliberately omitted from a statute is strongest when Congress

has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement.

The discussion of implied remedies in both the majority and minority opinions in *Middlesex Cty. Sewerage Auth.* v. *Nat. Sea Clammers*, 453 U.S. 1 (1981) indicates clearly that no § 10(b) remedy should be implied for the benefit of securities purchasers who have a § 11 remedy. Under the majority approach, the absence of any expression of congressional intent to create under § 10(b) any private remedy whatever would be determinative here.[13] 453 U.S. 1, ___, 101 S.Ct. 2615, 2622. Similarly, the minority opinion states that "the primary question is whether the statute was enacted for the special benefit of a particular class of which the plaintiff is a member." 453 U.S. 1, ___, 101 S.Ct. 2615, 2633. It is hardly imaginable that a securities purchaser having available to him the elaborate remedies provided by § 11 is within the class of persons for whose special benefit § 10(b) was enacted.[14]

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[13] In *Blue Chip Stamps* this Court commented both on the absence of any legislative history indicating that Congress considered the problem of private suits when it enacted § 10(b) and on the lack of any indication that the Commission considered the issue in adopting Rule 10b-5. 421 U.S. at 732.

[14] In *Piper* v. *Chris-Craft Industries*, 430 U.S. 1, 37 (1977) this Court explained its refusal to imply a remedy under the Williams Act for the benefit of a tender offeror on the grounds that the offeror was not within the class "for whose special benefit the statute was enacted." In his dissenting opinion in *Blue Chip Stamps*, Mr. Justice Blackmun noted that the Commission in adopting Rule 10b-5 issued a press release stating that the new rule closed a loophole for the benefit of sellers of securities. 421 U.S. at 766-67. Therefore, if in adopting Rule 10b-5 the Commission correctly discerned the intent of Congress as to the special class for whose benefit § 10(b) and Rule 10b-5 should operate, that class would be sellers of securities not previously protected by the statutory scheme and not purchasers of registered securities already protected by § 11.

We submit that the present is a proper time for the Supreme Court to address directly the issue of implied remedies under § 10(b) and § 17(a). Certainly, there could be no more compelling fact situation to do so than that here presented. If the grounds justifying the exceptional treatment of § 10(b) require that a remedy be implied for every purchase or sale of a security, notwithstanding the obvious anomalies which arise where an express § 11 remedy exists for the same transaction, then this Court should so hold and should state, for the benefit of the lower federal courts, the basis for this result. This direct approach would be preferable to the continued disregard by the lower federal courts in § 10(b) cases of the holdings of this Court.[15]

Perhaps the best argument for granting certiorari is found in Mr. Justice Harlan's dissenting opinion in *National Securities, Inc.*, 393 U.S. at 472:

> I am unwilling to decide these fundamental matters [concerning, among other things, the existence of § 10(b) implied remedies where express remedies are available] without full-dress argument. Indeed, if the courts of appeals are not to be permitted to develop the law in this area on a case-by-case basis, I think it much wiser for us to consider the basic issues in a case which squarely raises them rather than in one which is of marginal importance.

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[15] In a decision discussed here only because it is the latest in the series of similar decisions, the court in *Roth v. Bank of the Commonwealth*, [1981] CCH Fed. Sec. L. Rep. ¶ 98,267 (W.D.N.Y. August 17, 1981) upheld the right of plaintiffs to pursue simultaneously remedies under § 10(b) and under §§ 12(2) and 17(a) of the 1933 Act, quoting the statement in *Leist v. Simplot*, 638 F.2d 283, 316 (2d Cir. 1980) *cert. granted sub nom. New York Mercantile Exchange v. Leist* (No. 80-757), 49 U.S.L.W. 3617, that "rumors about the death of the implied cause of action . . . are exaggerated." One would suppose that causes of action may, unlike Mark Twain, be more or less dead.

CONCLUSION

The writ of certiorari should be granted.

Respectfully submitted

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October 8, 1981

Appendix

Ralph E. HUDDLESTON and Chester E. Bradley, Jr., Individually and as designated Class Representatives, Plaintiffs-Appellees,

v.

HERMAN & MacLEAN, etc., et al., Defendants,

Herman & MacLean, Certified Public Accountants, a partnership, and Lawrence A. LoPatin, Leslie Share, Defendants-Appellants.

No. 79-3712.

United States Court of Appeals,
Fifth Circuit.
Unit A

March 9, 1981.

Appeals from the United States District Court for the Northern District of Texas.

Before WISDOM, RUBIN, and SAM D. JOHNSON, Circuit Judges.

ALVIN B. RUBIN, Circuit Judge:

This eight-year securities litigation traverses the gamut of Rule 10b-5 issues. After lengthy discovery and a three-week trial to a jury, a judgment was entered on the basis of the jury's special verdict in answer to specific factual interrogatories. Despite this carnage, the battle must again

be joined because the district court failed to submit crucial issues on reliance and causation to the jury. Although the judgment must be reversed, we nevertheless affirm the ruling that there is an implied cause of action under Section 10(b) of the Securities Exchange Act of 1934 even when an express cause of action is created by other sections of the federal securities laws. We reverse the judgment holding that corporate officers and accountants who prepare the corporate issuer's prospectus in connection with a securities offering are sellers of those securities under the Texas Securities Act. Finally, we consider other issues likely to recur at the unfortunately necessary new trial.

I.

FACTS

Texas International Speedway, Inc. [TIS] filed a registration statement and prospectus with the Securities and Exchange Commission [SEC] and the Texas State Securities Board offering a total of $4,398,900 in securities, the proceeds of which were to be used to construct an automobile racetrack called the Texas International Speedway. The entire issue was sold on the offering date, October 30, 1969. The corporation was nonetheless short-lived, for on November 30, 1970, TIS filed a petition for bankruptcy under Chapter X of the Bankruptcy Act.

In 1972, the plaintiffs on behalf of themselves and other purchasers of TIS securities filed this class action alleging claims under Section 10(b) of the Securities Exchange Act of 1934 [the 1934 Act] and Rule 10b-5 promulgated pursuant to that statute. While the class action complaint alleged a panoply of federal and state law violations, only two remain material: conspiracy to violate Section 10(b) of the 1934 Act and Rule 10b-5 and conspiracy to violate the Texas Securities Act [TSA], a pendent claim. The complaint sought damages from LoPatin, the former President,

Treasurer and Director of TIS; Share, the former Executive Vice-President and Director of TIS; Herman and MacLean [H&M], the accountants who had participated in preparation of the prospectus, and others.[1]

With court approval, the class compromised its claims against the underwriters for $275,000 and those against the speedway contractor for $50,000. The court order stated that "the release of any of the settling defendants is not to be treated as the release of a joint tort-feasor under common law." The amounts received in settlement were credited against the judgment eventually obtained by the plaintiffs but the nonsettling defendants' cross-claims for contribution were disallowed.

The issues that now concern us focus on statements made in the TIS prospectus. It contained an audited balance sheet dated May 31, 1969, and an unaudited balance sheet dated August 31, 1969. It related that the speedway was under construction and the proceeds of the securities issue would be used to pay the costs of that construction. It also contained a pro forma balance sheet dated May 31, 1969, showing that, upon completion of the public offering of the securities and the application of the proceeds to the construction costs of the speedway, TIS would on the speed-

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[1] The district court certified the class action and designated the class as those who had purchased TIS securities during the ninety-day period beginning with the effective date of the registration statement, October 30, 1969, and ending on January 28, 1970, based on the requirement that the prospectus be "kept effective" for a ninety-day period after the effective date of the registration statement. *See* Sections 4(3) and 5(b)(2) of the Securities Act of 1933 [the 1933 Act], 15 U.S.C. §§ 77d(3) and 77e(b)(2). *See also* 5 A. Jacobs, The Impact of Rule 10b-5 § 61.01[c][i], at 3-37 (Supp.1980) (Rule 10b-5 requires accuracy of the registration statement on each day during which securities are being distributed under the registration statement and during a ninety-day period after the effective date if the 1933 Act necessitates that dealers deliver a prospectus then).

way's opening date have $93,870 in cash on hand after allocation of $295,771 for general administrative expenses.

The trial judge submitted the case to the jury on special issues concerning whether the prospectus was materially misleading and, if so, whether this was done with scienter of various defendants. Despite the defendants' requests, he refused to submit special issues relating to reliance and causation.

The jury found that the prospectus was materially misleading as to the cost of constructing the speedway and that the defendants had "failed to disclose" the true facts with reckless disregard for the truth.[2] The trial judge then himself determined the amount of damages and entered judgment for the plaintiffs and against LoPatin, Share and H&M.

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[2] The jury's findings were in part:

I. The TIS prospectus was "*materially misleading* as to . . .

(a) The cost of purchasing land for and completing the facilities of the Texas Speedway identified in the Use of Proceeds section and to place those facilities in operation.

(b) The working capital position of TIS on October 30, 1969."

II. LoPatin, Share and H&M "*failed to disclose*" the matters mentioned above "with reckless disregard for the truth."

III. In connection with the sale of TIS securities, LoPatin and Share engaged in the following acts, transactions or practices that would be material facts to the reasonable investor:

"(a) Caused the pro forma transactions that are part of the May 31, 1969, pro forma balance sheet in the October 30, 1969, Registration Statement to show that TIS would have $93,870.00 of cash available for general corporate purposes after an allowance of $295,771.00 for funds to be used for general administrative expenses to the opening date of the Texas Speedway.

(b) Caused Defendant Buchanan to execute a consent dated October 24, 1969, to allow its name to be used as an expert in the penultimate paragraph under the Use of Proceeds section and the fourth paragraph of the Plant

II

THE IMPLICATION OF A PRIVATE CAUSE OF ACTION UNDER SECTION 10(b) AND RULE 10b-5 DESPITE THE APPLICABILITY OF EXPRESS CIVIL LIABILITY PROVISIONS

The Securities Act of 1933, 15 U.S.C. § 77a *et seq.*, [the 1933 Act] and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.*, [the 1934 Act] each authorizes specific private civil actions for damages arising out of statutory violation.[3] Together they "constitute interrelated components of the federal regulatory scheme governing transactions in securities." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206, 96 S.Ct. 1375, 1387, 47 L.Ed. 668, 684 (1976).

Each of the Acts contains general prohibitory sections that neither specifically authorize nor forbid a private cause

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and Property sections without requiring Buchanan to perform due diligence procedures to ascertain the accuracy of the cost estimates set forth therein.

• • •

(d) Caused TIS on October 21, 1969, to borrow $100,000.00 from Holloway Construction Company without disclosing in the October 30, 1969, Registration Statement that such borrowings had been obtained from a company affiliated with the principal contractor for the Texas Speedway."

IV. LoPatin *and* Share engaged in the transactions or acts described in paragraphs (a) and (d) in number III above "with intent to deceive or defraud" while only Share engaged in the transaction represented in paragraph (b) of number III above with such an intent.

V. LoPatin, Share and H&M were "sellers" under the Texas Securities Act.

[3] *See, e. g.*, Sections 11, 12 and 15 of the 1933 Act, 15 U.S.C. §§ 77k, 77l, 77o; and Sections 9(e), 16(b), 18(a) and 20 of the 1934 Act, 15 U.S.C. §§ 78i(e), 78p(b), 78r(a) and 78t. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 571, 99 S.Ct. 2479, 2487, 61 L.Ed.2d 82 (1979).

of action. In a series of separate decisions, spanning four decades, courts have found that many of these provisions, including Section 10(b) and SEC Rule 10b-5, imply a private judicial remedy.[4]

The plaintiffs alleged violations of Section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a), Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, all of which have been held to imply a private action. However, the alleged misrepresentations in the prospectus would also warrant a suit under Sections 11 and 12(2) of the 1933 Act, 15 U.S.C. §§ 77k and 77*l*(2). The apparent overlap in the applicability of the express liability provisions of the 1933 Act and the implied remedies raises the issue whether an implied cause of action is available when an express cause of action has been created, a question reserved by the Supreme Court in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 n.15, 95 S.Ct. 1917, 1933 n.15, 44 L.Ed.2d 539, 559 n.15 (1975), and again left open in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 211 n.31, 96 S.Ct. 1375, 1389

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[4] *See, e. g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196, 96 S.Ct. 1375, 47 L.Ed.2d 668, 678 (1976) (Section 10(b) of the 1934 Act and SEC Rule 10b-5 imply a private cause of action); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730, 95 S.Ct. 1917, 1922, 44 L.Ed.2d 539, 546 (1975) (same). *See also Lincoln National Bank v. Herber*, 604 F.2d 1038, 1040 n.2 (7th Cir. 1979) [finding a cause of action under § 17(a) of the 1933 Act, 15 U.S.C. § 77q(a)]; *Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir. 1978), *cert. denied*, 442 U.S. 909, 99 S.Ct. 2821, 61 L.Ed.2d 274 and *cert. denied sub nom.*, 444 U.S. 995, 100 S.Ct. 531, 62 L.Ed.2d 426 (1979) (same); *Newman v. Prior*, 518 F.2d 97, 99 (4th Cir. 1975) (same). *But see Shull v. Dain, Kalman & Quail, Inc.*, 561 F.2d 152, 159 (8th Cir. 1977), *cert. denied*, 434 U.S. 1086, 98 S.Ct. 1281, 55 L.Ed.2d 792 (1978) [rejecting implied action under § 17(a)]. *See generally* R. Jennings & H. Marsh, Securities Regulation 863-64 (4th ed. 1977) [hereinafter cited as Jennings & Marsh]; Hazen, A. Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933, 64 Va.L.Rev. 641 (1978).

n.31, 47 L.Ed.2d 668, 687 n.31 (1976), in considering the relationship of Section 10(b) and Section 18 of the 1934 Act, 15 U.S.C. § 78r.

The classic reconciliation of the apparent overlap of the express civil liability provisions of the 1933 Act and the cause of action implied in Rule 10b-5 is, according to 4 A. Bromberg, Securities Law: Fraud — SEC Rule 10b-5 § 2.4, at 384.6 (Supp.1977), provided by *Fischmann v. Raytheon MFG. Co.*, 188 F.2d 783 (2d Cir. 1951). In *Fishman*, the common stockholders who were the plaintiffs contended that they were injured by the misstatements in a registration statement pursuant to which preferred stock was issued. Because they had not purchased the registered securities, they had no claim under Section 11 of the 1933 Act. The trial court held that these common stockholders were not entitled to relief under Rule 10b-5 because to allow such a claim would circumvent the restrictions imposed in an action under Section 11. The Second Circuit, reversing the district court, noted that proof of fraud is required under Rule 10b-5 but not required in a Section 11 action. "We think that when, to conduct actionable under § 11 of the 1933 Act, there is added the ingredient of fraud, then that conduct becomes actionable under § 10(b) of the 1934 Act and the Rule...." 188 F.2d at 786-87.[5]

Moreover, in *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969), the Supreme Court considered the contention that Rule 10b-5 does not cover misrepresentations in connection with proxy solicitations in the light of Section 14 of the 1934 Act, 15 U.S.C. § 78n, which provides a complex regulatory scheme covering such solicitations. "[T]he existence or nonexistence of regulation under § 14," the Court said, "would not affect the scope

[5] *Fischman* is distinguishable from the present case because the plaintiffs here apparently did have a Section 11 remedy whereas the common stockholders in *Fischman* did not. However, we think the *Fischman* rationale is nevertheless applicable here.

of § 10(b) and Rule 10b-5. The two sections of the [1934] Act apply to different sets of situations. Section 10(b) applies to all proscribed conduct in connection with a purchase or sale of any security; § 14 applies to all proxy solicitations, whether or not in connection with a purchase or sale. *The fact that there may well be some overlap is neither unusual nor unfortunate.*" 393 U.S. at 468, 89 S.Ct. at 573, 21 L.Ed.2d at 680 (emphasis added).

However, recent Supreme Court decisions curtailing the broader sweep given the Securities Acts by lower federal courts[6] together with the footnote observations in *Ernst & Ernst* and *Blue Chip Stamps* recognizing, without deciding, the overlap issue, give substance to the argument that no remedy should be implied for actions covered by express liability provisions of the statutes.[7]

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[6] *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 99 S.Ct. 2479, 61 L.Ed.2d 82 (1979); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 100 S.Ct. 242, 62 L.Ed.2d 146 (1979); *Chiarella v. United States*, 445 U.S. 222, 100 St.Ct. 1108, 63 L.Ed.2d 348 (1980).

[7] Before the decisions cited in note 6, *supra*, the lower federal courts and the commentators appeared to agree that a Rule 10b-5 action could be brought for conduct covered by the express liability provisions of the 1933 and 1934 Acts. 1 A. Bromberg, Securities Law: Fraud – SEC Rule 10b-5 § 2.4(1), at 27-28 (1967). *See e.g., Schaefer v. First National Bank of Lincolnwood*, 509 F.2d 1287, 1292 (7th Cir. 1975), *cert. denied*, 425 U.S. 943, 96 S.Ct. 1682, 48 L.Ed.2d 186 (1976); *Jordan Building Corp. v. Doyle, O'Connor & Co.*, 401 F.2d 47 (7th Cir. 1968); *Ellis v. Carter*, 291 F.2d 270 (9th Cir. 1961); *Matheson v. Armbrust*, 284 F.2d 670, 674 (9th Cir. 1960), *cert. denied*, 365 U.S. 870, 81 S.Ct. 904, 5 L.Ed.2d 860 (1961); *Fischman v. Raytheon MFG. Co.*, 188 F.2d 783 (2d Cir. 1951); *Beecher v. Able*, 435 F.Supp. 397, 412-13 (S.D.N.Y. 1977); *Orn v. Eastman Dillon, Union Securities*

Two circuit courts have recently addressed the question.[8] The Second Circuit adopted the *Fischman* rationale in *Ross v. A. H. Robins Co.*, 607 F.2d 545 (2d Cir. 1979), *cert.* denied, 446 U.S. 946, 100 S.Ct. 2175, 64 L.Ed.2d 802 (1980), holding that cause of action may be implied in Section 10(b) and Rule 10b-5 for conduct that might also permit suit under Section 18 of the 1934 Act, 15 U.S.C. § 78r. While this court had the present case under advisement, the District of Columbia Circuit took the same position, holding that a remedy is implied under Section 10(b) of the 1934 Act despite the possibility of overlap between that implied cause of action and express remedies provided by other sections of the securities laws. *Wachovia Bank and Trust Co. v. Natinoal Student Marketing Corp.*, No. 79-1595, —— F.2d —— (D.C. Cir. 1980). *See generally* Note, Rule 10b-5: The Circuits Debate the Exclusivity of Remedies, The Purchaser-Seller Requirement, and Constructive Deception, 37 Wash. and Lee L.Rev. 877 (1980).

[1] These decisions reason that the courts "are not being asked to create a new judicial remedy. It is well established that a private remedy exists" under Section 10(b) and Rule 10b-5. *Ross v. A. H. Robbins Co.*, 607 F.2d at 553.[9]

& Co., 364 F.Supp. 352 (C.D.Cal. 1973); *Stewart v. Bennett*, 359 F.Supp. 878 (D.Mass.1973). *But see Gilbert v. Nixon*, 429 F.2d 348, 355 (10th Cir. 1970).

[8] The district courts have differed on the solution to the overlap issue. *Compare McFarland v. Memorex Corp.*, 493 F.Supp. 631, 653-55 (N.D.Cal. 1980) *with Beecher v. Able*, 435 F.Supp. 397, 412 (S.D.N.Y. 1977).

[9] *See, e.g., Touche Ross & Co. v. Redington*, 442 U.S. 560, 577 n. 19, 99 S.Ct. 2479, 2490 n. 19, 61 L.Ed.2d 82, 97 n. 19 (1979); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196, 96 S.Ct. 1375, 1382, 47 L.Ed.2d 668, 678 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730, 95 S.Ct. 1917, 1922, 44 L.Ed.2d 539, 546 (1975); *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n. 9, 92 S.Ct. 165, 169 n. 9, 30 L.Ed.2d 128, 134 n. 9 (1971).

The question is whether an established remedy may be invoked despite the existence of another remedy for the same conduct. While Sections 11 and 12(2) of the 1933 Act, like Section 18 of the 1934 Act, contain limitations and requirements not exacted of Section 10(b) litigants, allowing invocation of the Section 10(b) remedy does not impermissibly nullify those constraints. To prevail under Section 10(b) a plaintiff must prove facts not necessary to recovery under the provisions of the 1933 Act. To recover under Section 10(b), the plaintiff must prove deceit[10] committed with scienter.[11]

[2] While here the alleged deceitful statements were lodged in a registration statement filed with the SEC, thus implicating the express liability provisions of the 1933 Act, to draw the distinction suggested and deny the implied action under Section 10(b) would make the existence of the action under Section 10(b) depend on whether the statement relied upon was or was not contained in an SEC filing. If deceitful statements were made both in SEC filings and elsewhere, then the existence of the Section 10(b) cause of action might depend on whether the investor relied on one or the other. To hold that the purchasers in this case must be limited to the express liability provisions of the 1933 Act because the false statements were made in the prospectus filed with the SEC, would, as the Court observed in *Ross*, "encourage corporate managers to include these misrepresentations in material filed with the S.E.C., for the sole purpose of insulating themselves from liability under § 10(b) and restricting the class of potential plaintiffs to the unlikely few who actually viewed and relied on the misleading information." 607 F.2d at 556.

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[10] *See Chiarella v. United States*, 445 U.S. 222, 226, 100 S.Ct. 1108, 1113, 63 L.Ed.2d 348, 354 (1980); *Wachovia Bank and Trust Co. v. National Student Marketing Corp.*, No. 79-1595, F.2d , at , slip op. at 29 (D.C.Cir. 1980).

[11] *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). *Cf. Aaron v. SEC*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980).

Therefore, we hold that a cause of action lies under Section 10(b) of the 1934 Act and Rule 10b-5 even if the deceit that is the basis for the Section 10(b) action may also be actionable under other express liability provisions of the Securities law.

III.

ELEMENTS OF THE CAUSE OF ACTION UNDER SECTION 10(b) AND RULE 10b-5

The elements necessary to prove a Section 10(b) claim have been so often applied by the lower federal courts that they can be stated in black letter fashion. To make out a claim under Section 10(b), which is based on the common law action of deceit, the plaintiff must establish (1) a misstatement or an omission (2) of material fact (3) made with scienter (4) on which the plaintiff relied (5) that proximately caused his injury.[12] We discuss each of these prerequisites in turn.

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[12] *See Croy v. Campbell*, 624 F.2d 709, 715 (5th Cir. 1980); *Cameron v. Outdoor Resorts of America, Inc.*, 608 F.2d 187, 193-94 (5th Cir. 1979), *aff'd in part, vacated and remanded in part of rehearing*, 611 F.2d 105 (5th Cir. 1980); *Moody v. Bache & Co., Inc.*, 570 F.2d 523, 527 (5th Cir. 1978); *Dupuy v. Dupuy*, 551 F.2d 1005, 1014 (5th Cir.), *cert. denied*, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977); *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314-15 (5th Cir. 1977), *cert. denied sub nom.*, 435 U.S. 952, 98 S.Ct. 1580, 55 L.Ed.2d 802 (1978). *See generally* 5 A. Jacobs, The Impact of Rule 10b-5 § 36, at 2-4 & n. 14 (Supp. 1980). This court has also formulated the elements of the Section 10(b) claim as follows: (1) conduct by the defendants proscribed by the rule; (2) a purchase or sale of securities by the plaintiffs "in connection with" such proscribed conduct; (3) and resultant damages to the plaintiffs. *Alley v. Miramon*, 614 F.2d 1372, 1378 n. 10(5th Cir. 1980); *Falls v. Fickling*, 621 F.2d 1362, 1365 (5th Cir. 1980); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 93 (5th Cir. 1975); *Sargent v. Genesco, Inc.*, 492 F.2d 750, 759 (5th Cir. 1974).

A. Materiality

Considering the definition of a material fact under Section 14(a) of the 1934 Act and the SEC rules governing proxy statements, the Supreme Court, in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), adopted a 'general standard of materiality . . . as follows: An omitted fact is material if there is a substantial likelihood that a reasonable shareholder *would* [not *might*]consider it important in deciding how to vote." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. at 449, 96 S.Ct. at 2132, 48 L.Ed.2d at 766 (emphasis added). "[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 449, 96 S.Ct. at 2132, 48 L.Ed.2d at 766. "In this circuit, the test of materiality [under Rule 10b-5] is 'whether a reasonable man would attach importance to the fact misrepresented in determining his course of action.' *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 603-04 (5th Cir.), *cert. denied*, 419 U.S. 873, 95 S.Ct. 134, 42 L.Ed.2d 113 (1974)." *Falls v. Fickling*, 621 F.2d 1362, 1365 n. 9 (5th Cir. 1980). *See also Wheat v. Hall*, 535 F.2d 874, 876 (5th Cir. 1976); *John R. Lewis, Inc. v. Newman*, 446 F.2d 800, 804 (5th Cir. 1971). *See generally* Project, Recent Developments in Securities Law; Causes of Action Under Rule 10b-5, 26 Buffalo L.Rev. 503, 516-22 (1977).

[3] The TIS prospectus warned the potential investor that "THESE SECURITIES INVOLVE A HIGH DEGREE OF RISK" and that the construction costs might be underestimated. Nonetheless, there was evidence from which the jury might have inferred that, on the effective date of the registration statement, LoPatin, Share and H&M already knew that the cost of construction was understated and that consequently the Company's working capital posi-

tion would not be as favorable as the prospetcus reflected.[13] To warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.

Considering the evidence presented, the jury could justifiably conclude that the prospectus misstated the costs of completion of the speedway, the amount of working capital that would be available to the Company and the urgency of TIS's need to generate funds from the operation of the speedway.

Each of these facts, and, certainly their combined significance could all be considered important in the total mix of information considered by the securities purchaser. The fact that it is not unusual for the final cost of construction to exceed the contract price does not condone the deliberate misstatement of the cost anticipated on the basis of known events. The very fact that LoPatin and Share reduced certain estimated construction costs to prevent cost estimates from exceeding the estimates of available funds before the

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[13] The record establishes that the accountants, in a letter written by Mr. Herman in May of 1969, informed Mr. Share that construction costs would exceed available funds, and that this letter was followed shortly thereafter by a June, 1969, meeting of LoPatin, Share and Herman as a result of which certain construction costs, such as paving and seeding, were reduced or eliminated from the construction budget. However, other evidence indicated that bids had already been accepted to undertake the construction work "eliminated" from the budget at the June, 1969, meeting. Finally, in October, 1969, before the effective date of the registration statement, H&M refused to provide the underwriters with a comfort letter making reference to the construction cost and administrative expenses detailed in the Use of Proceeds section of the prospectus. The jury was justified in inferring from these facts and the other circumstantial evidence that LoPatin, Share and Herman misstated the estimated construction costs in the prospectus.

construction budget appeared in the prospectus, and the later revelation of construction cost "overruns" to the SEC in January, 1970, indicate that LoPatin, Share and H&M believed that the costs of completion figures would be considered important by the potential investor in making his ultimate investment decision. We conclude, therefore, that there was sufficient evidence to warrant the finding of materiality of the misstatements.[14]

B. Scienter

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), the Supreme Court held that the Rule 10b-5 implied cause of action requires a showing of scienter. *See also Aaron v. SEC*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980). The Court defined the term as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 193 n. 12, 96 S.Ct. at 1381 n. 12, 47 L.Ed.2d at 677 n. 12. In *Aaron* the Court expressly did not "address the question, reserved in *Hochfelder*, . . . whether, under some circumstances, scienter may also include reckless behavior." 446 U.S. at 686 n. 5, 100 S.Ct. at 1950 n. 5, 64 L.Ed.2d at 620 n. 5.

[4] This circuit's position on whether reckless behavior is sufficient to establish scienter is presently uncertain because the panel decision in *Broad v. Rockwell International Corp.*, 614 F.2d 418 (5th Cir. 1980), was vacated by the granting of a rehearing en banc in that case, 618 F.2d 396 (5th Cir. 1980). *See Dwoskin v. Rollins, Inc.*, 634 F.2d 285,

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[14] LoPatin and Share claim that the alleged misstatements were immaterial as a "matter of law." Only where the facts are so obviously important [or unimportant] to an investor that reasonable minds cannot differ on the question of materiality may the ultimate materiality issue properly be resolved as a matter of law. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. at 450, 96 S.Ct. at 2133, 48 L.Ed.2d at 766.

289 (5th Cir. 1981). The panel in *Broad*, concurring in the position accepted by a number of other circuits,[15] had expressly held that recklessness was sufficient to establish scienter. In cases decided both before and after the *Broad* decision, we have referred to establishing scienter by proof of reckless conduct.[16] We here conclude that recklessness can, under certain circumstances, be sufficient to establish scienter for purposes of the cause of action under Rule 10b-5. *See G. A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945 (5th Cir. 1981), in which another panel of this court recently reached this same conclusion and adopted the recklessness standard.

Reckless conduct sufficient to serve as scienter must involve more than simple, or even inexcusable negligence. It requires "an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *SEC v. Southwest Coal & Energy Co.*, 624 F.2d 1312, 1321 n. 17 (5th

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[15] *See, e. g., Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1023 (6th Cir. 1979); *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 44 (2d Cir.), *cert denied*, 439 U.S. 1039, 99 S.Ct. 642, 58 L.Ed.2d 698 (1978); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied sub nom.*, 434 U.S. 875, 98 S.Ct. 224, 54 L.Ed.2d 155 (1977); *Sanders v. John Nuveen & Co., Inc.*, 554 F.2d 790, 793 (7th Cir. 1977).

[16] *See SEC v. Southwest Coal & Energy Co.*, 624 F.2d 1312, 1321 & n.17 (5th Cir. 1980) (dicta) (an SEC enforcement case); *Croy v. Campbell*, 624 F.2d 709, 715-16 (5th Cir. 1980) (adopting the recklessness standard set out in *Broad*); *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied sub nom.*, 435 U.S. 952, 98 S.Ct. 1580, 55 L.Ed.2d 802 (1978). *See generally* A. Jacobs, Rule 10b-5 Developments – Who Can Sue and Who is Liable, Tenth Annual Institute on Securities Regulation 457, 465-70 (1979); Comment, Recklessness and the Rule 10b-5 Scienter Standard After Hochfelder, 48 Fordham L.Rev. 817 (1980).

Cir. 1980) [quoting *Franke v. Midwestern Oklahoma Development Authority*, 428 F. Supp. 719, 725 (W.D.Okl. 1976)] (SEC enforcement case). *See, e.g., McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1025 (6th Cir. 1979).

[5] The trial court correctly charged the jury that scienter could be established by proof of "conduct which is so extreme as to be a form of intentional conduct or behavior equivalent to an intent to deceive, manipulate or defraud."[17]

[6] LoPatin, Share and H&M contend that the trial court erroneously failed to ...rect a verdict in their favor on the basis that the evidence was insufficient to demonstrate scienter even under this recklessness standard. There was, of course, no direct testimony that any of the defendants acted knowingly with intention to deceive potential investors. However, circumstantial evidence presented to the jury would permit the inference that the misstatements in the prospectus were made with the requisite scienter. Extrinsic facts can be used to establish scienter in a Rule 10b-5 action. *See* 5 A. Jacobs, The Impact of Rule 10b-5 § 63, at 3-219 (Supp. 1980).

[7] We note that the trial court charged the jury using the "preponderance of the evidence" standard, the usual burden of proof required in civil cases. Thus, the interrogatories propounded to the jury required it to make its finding of the requisite scienter, as well as the other elements of the Rule 10b-5 action, by only a preponderance of the evidence. However, as the Supreme Court made clear in *Hochfelder*,

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[17] The jury charge continued: "To be equivalent to such intent, recklessness must be conduct which is highly unreasonable, involving not merely simple or even inexcusable negligence but extreme departure from the standards of ordinary care and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the defendant must have been aware of it."

Rule 10b-5 is an anti-fraud provision: to prevail in an action brought pursuant to the Rule, the plaintiff must establish that the defendant acted with an "intent to . . . defraud." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 n. 12, 96 S.Ct. 1375, 1381 n. 12, 47 L.Ed.2d 668, 677 n. 12 (1976). The traditional burden of proof imposed in cases involving allegations of civil fraud is the "clear and convincing" evidence standard.[18] We conclude that the higher threshold of proof of fraud required in Rule 10b-5 actions mandates that the plaintiffs prove their case under the higher burden of proof.[19]

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[18] *See Addington v. Texas*, 441 U.S. 418, 423, 99 S.Ct. 1804, 1808, 60 L.Ed.2d 323, 329 (1979) (dicta); *Woodby v. Immmigration & Naturalization Service*, 385 U.S. 276, 285-86 & n. 18, 87 S.Ct. 483, 488 & n.18, 17 L.Ed.2d 362, 369 & n.18 (1966) (dicta). *See, e. g., Merit Ins. Co. v. Colao*, 603 F.2d 654, 658 (7th Cir. 1979), *cert. denied*, 445 U.S. 929, 100 S.Ct. 1318, 63 L.Ed.2d 763 (1980) (Illinois law); *Ajax Hardware MFG Corp. v. Industrial Plants Corp.*, 569 F.2d 181, 186 (2d Cir. 1977) (New York law). *See generally* 9 Wigmore, Evidence § 2498, at 329 (3d ed. 1940).

[19] The Supreme Court recently affirmed this court's refusal in *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979), *cert. granted*, 446 U.S. 917, 100 S.Ct. 1849-50, 64 L.Ed.2d 271 (1980), to impose the higher "clear and convincing" burden of proof upon the SEC in its agency determinations of anti-fraud securities laws violations. *Steadman v. SEC*, (Feb. 25, 1981). The *Steadman* decision is based on the congressional intent as revealed by the language and legislative history of Section 7(c) of the Administrative Procedure Act, 5 U.S.C. § 556(d), and the holding is, therefore, limited to the appropriate burden of proof in an administrative proceeding. There is no suggestion in the Supreme Court's *Steadman* opinion that the holding has any application in the context of a private cause of action brought in district court. We find the private plaintiff's Rule 10b-5 action comparable to the civil fraud action in which proof of intent to deceive is often a matter of inference, *see* text at note 21, *infra*, and judgment for the plaintiff detracts from the defendant's reputation to a far greater extent than in other civil litigation. Thus, the higher burden of proof is appropriate. The *Steadman* decision is distin-

The failure of the district court to charge the jury as to the "clear and convincing" burden of proof does not, however, affect our determination of the merits of this case for we conclude that, even under that standard, the jury could infer from the evidence presented that the defendants acted with the requisite scienter in regard to the material misstatements in the prospectus.

[8, 9] Whether a defendant's actions in a Rule 10b-5 case violate the standard of care imposed by the Rule, thus establishing scienter, is a question of fact to be determined as of the time of the actions about which the plaintiff is complaining. 5 A. Jacobs, The Impact of Rule 10b-5 § 63, at 3-215 (Supp. 1980). *See Holmes v. Bateson*, 583 F.2d 542, 552 (1st Cir. 1978). The evidence was sufficient to warrant, although it did not compel, the inference that each of the defendants acted with the requisite state of mind.[20]

Herman contends that the evidence failed to establish scienter on his part because he was not privy to all the information available to LoPatin and Share and because he relied on the construction cost figures they submitted to him and was not aware of the inaccuracy of those estimated costs. There was expert testimony that H&M was, to some degree, negligent in its accounting procedures. Although such negligence could not, under the standard articulated in *Hochfelder*, establish the requisite scienter, the jury might

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guishable and, therefore, not binding in this case. The issue of burden of proof was not raised in the parties briefs. However, it is inextricably interwoven with the sufficiency of the evidence of scienter and will doubtless arise as an issue in the new trial.

[20] The defendants all contend that the cost reductions were bona fide and that the later expenditures resulted from unanticipated events. The plaintiffs, on the other hand, contend that the adjustment to reduce costs was a sham and that LoPatin, Share and Herman knew from the outset that the work eliminated from the Use of Proceeds section would nonetheless be completed and the concomitant costs incurred.

reasonably have concluded from Herman's testimony and from any inference to be drawn from his involvement in the preparation of the Use of Proceeds section of the prospectus, as well as from the refusal of H&M in October, 1969, to provide a comfort letter to the underwriters referring to the construction costs in the prospectus, that H&M acted with the requisite scienter. "Proof of a defendant's knowledge or intent [in a Rule 10b-5 action] will often be inferential . . . ." *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 47 (2d Cir.), *cert. denied*, 439 U.S. 1039, 99 S.Ct. 642, 58 L.Ed.2d 698 (1978).[21] We conclude that the circumstantial evidence was sufficient to preclude a directed verdict in favor of H&M.

C. Reliance and Causation

Reliance and causation are related concepts. In the common lay deceit action from which the Rule 10b-5 claim is derived, it was necessary for the plaintiff to show reliance on the defendant's fraudulent representations as a prerequisite to recovery. Establishing reliance, however, merely proves that the plaintiff was induced to act by the defendant's conduct. It is a nonsequitur to conclude that the representation that induced action necessarily caused the consequences of that action. As we have seen, the general statement of the elements of recovery under Rule 10b-5 requires proof both that the plaintiff relied on the misstatement and that the misstatement was the cause of his loss.

In *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972), the Supreme Court held that in some circumstances affirmative proof of

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[21] The implied cause of action under Rule 10b-5 "is essentially a tort claim," *Moody v. Bache & Co.*, 570 F.2d 523, 527 (5th Cir. 1978), derived from the common law action of deceit. The scienter element in the common law action may be inferred from the surrounding circumstances. *See* W. Prosser, The Law of Torts § 107, at 701-02 (4th ed. 1971).

reliance is not necessary. It distinguished the three subparagraphs of Rule 10b-5,[22] pointing out that the first and third subparagraphs are not restricted to the misstatement or omission of a material fact but forbid a "course of business" or a "device, scheme, or artifice" that operates as a fraud. If a person who has an "affirmative duty under the Rule to disclose" a material fact to the holder of a security devises a plan to induce the holder to sell the securities without disclosing to him material facts that reasonably could be expected to influence his decision to sell, positive proof of reliance, it held, is not a prerequisite to recovery. Under the circumstances of that case, "involving primarily a failure to disclose . . . [a]ll that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. . . . This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." 406 U.S. at 153-54, 92 S.Ct. at 1472, 31 L.Ed.2d at 761.

While *Affiliated Ute* relieves the investor in certain circumstances of the necessity of proving affirmatively that he relied on a prospectus or other representation, it does

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[22] Rule 10b-5, 17 C.F.R. § 240.10b-5, provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

not eliminate the reliance element from the Rule 10b-5 case altogether. *See Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973). In *Rifkin v. Crow*, 574 F.2d 256, 262 (5th Cir. 1978), we restated our understanding of the *Affiliated Ute* rationale as it relates to proof of reliance in a Rule 10b-5 action:

> [W]here a 10b-5 action alleges defendant made positive misrepresentations of material information, proof of reliance by the plaintiff upon the misrepresentation is required. Upon an absence of proof on the issue, plaintiff loses. On the other hand, where a plaintiff alleges deception by defendant's nondisclosure of material information, the *Ute* presumption obviates the need for plaintiff to prove actual reliance on the omitted information. Upon a failure of proof on the issue, defendant loses. But this presumption of reliance in nondisclosure cases is not conclusive. If defendant can prove that plaintiff did not rely, that is, that plaintiff's decision would not have been affected even if defendant had disclosed the omitted facts, then plaintiff's recovery is barred.

[10] Thus, reliance is an issue in *all* Rule 10b-5 cases. The difference between misrepresentation and non-disclosure cases relates only to whether proof of reliance is prerequisite to recovery or whether proof of non-reliance is an affirmative defense. *See Dwoskin* v. *Rollins, Inc.*, 634 F.2d 285, 294 n. 4 (5th Cir. 1981).

It is, therefore, necessary to characterize the facts in a Rule 10b-5 case as involving either primarily a failure to disclose, implicating the first or third subparagraph of the Rule and invoking the *Affiliated Use* presumption of reliance, or, on the other hand, primarily a misstatement or failure to state a fact necessary to make those statements made not misleading, classified under the second subparagraph of the Rule and as to which no presumption of

reliance is applicable. *Rifkin* v. *Crow*, 574 F.2d at 263. This case, involving alleged misstatements and omissions in a prospectus published pursuant to a public offering, cannot properly be characterized as an omissions case of the type for which the *Affiliated Ute* presumption was fashioned. The defendants did not "stand mute" in the face of a duty to disclose as did the defendants in *Affiliated Use*. 406 U.S. at 153, 92 S.Ct. at 1472, 31 L.Ed.2d at 761. They undertook instead to disclose relevant information in an offering statement now alleged to contain certain misstatements of fact and to fail to contain other facts necessary to make the statements made, in light of the circumstances, not misleading. This is not a case in which difficulties of proof of reliance require the application of the *Affiliated Ute* presumption. Because the plaintiffs were not entitled to a presumption of reliance, a jury finding that the plaintiffs relied upon the misstatements and omissions in the prospectus was essential to the plaintiff's recovery.

[11] This circuit, according to *Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973), requires "reasonable reliance" by the Rule 10b-5 plaintiff; "subjective reliance" alone does not suffice. 482 F.2d at 885. "[S]ome element of general reliance by plaintiff, even in nondisclosure cases, is essential to a Rule 10b-5 action." 482 F.2d at 884.

Subjective reliance is determined by the mental state of the individual. 5 A. Jacobs, The Impact of Rule 10b-5 § 64.-01[b][ii] (Supp.1980). Another measure of reliance used by some courts, "justifiable reliance," requires an objective or "reasonable man" test. *Id.* at § 64.-01[b][iii]. Although our prior decisions have not been completely clear on this point, we think "reasonable reliance," the test referred to by the *Simon* court, contemplates a subjective reliance standard, tempered by the requirement of due diligence on the part of the plaintiff, rather than the objective reliance test applicable under the justifiable reliance concept. *See,*

e. g., Dupuy v. Dupuy, 551 F.2d 1005, 1014 (5th Cir.), *cert. denied,* 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977). *See also* 5 A. Jacobs, The Impact of Rule 10b-5 § 64.01[b][iii], 3-252 & 3-253 & n.5 (Supp.1980).[23]

[12] The district court, induced by counsel, confused materially with reliance. The concepts are distinct and must be separately proved or disproved. Materiality does not necessarily imply that, were the truth known, the decision would be different. Thus, recovery is not permitted solely because the investor has relied on an immaterial misstatement or omission. *See* Project, Recent Developments in Securities Law: Causes of Action Under Rule 10b-5, 26 Buffalo L.Rev. 503, 523 (1977); 5 A. Jacobs, The Impact of Rule 10b-5 § 64.01[a], at 3-220 (Supp. 1980). On the other hand, even if a misstatement or omission might have been material to a reasonable investor, the plaintiff might not have relied on it, because, for example, he would have considered other factors more important or would have taken the same action even had he known the full truth. Consequently, in a class action, while the materality element can be established for the class as a whole, reliance, like damages, is a matter of individual proof. *See* 5 A. Jacobs, The Impact of Rule 10b-5 § 64.01[b][ii] (Supp. 1980).

[13, 14] The district court compounded its failure to submit the reliance issue to the jury by failing also to submit the question of causation. Causation is related to

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[23] We sustained a judgment for the defendant in *Simon* based on the finding that nothing said by the defendant broker was a factor in causing the plaintiff to buy stock. In a Rule 10b-5 action "[t]he plaintiff must show that it *reasonably relied* on the information (or on the notion that it had received all mandated disclosure from the defendant), and exercise due diligence in examining the information otherwise available to it." *First Virginia Bankshares v. Benson,* 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied sub nom.,* 435 U.S. 952, 98 S.Ct. 1580, 55 L.Ed.2d 802 (1978) (emphasis added).

but distinct from reliance. Reliance is a *causa sine qua non*, a type of "but for" requirement: had the investor known the truth he would not have acted.[24] Causation requires one further step in the analysis: even if the investor would not otherwise have acted, was the misrepresented fact a *proximate* cause of the loss? *Herpich v. Wallace*, 430 F.2d 792, 810 (5th Cir. 1970). The plaintiff must prove not only that, had he known the truth, he would not have acted, but in addition that the untruth was in some reasonably direct or proximate, way responsible for his loss. The causation requirement is satisfied in a Rule 10b-5 case only if the misrepresentation touches upon the reasons for the investment's decline in value. If the investment decision is induced by misstatements or omissions that are material and that were relied on by the claimant, but are not the proximate reason for his pecuniary loss, recovery under the Rule is not permitted.[25] *See Marbury Management, Inc.*

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[24] Courts sometimes consider the reliance component of the Rule 10b-5 action to be a part of the causation element. 5 A. Jacobs, The Impact of Rule 10b-5 § 64.01[a], at 3-221 (Supp. 1980). In this context, the term "transaction causation" is used to describe the requirement that the defendant's fraud must precipitate the investment decision. Reliance is necessarily closely related to "transaction causation." On the other hand, "loss causation" refers to a direct causal link between the misstatement and the claimant's economic loss. *See Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 720 (2d Cir. 1980) (Meskill, J., dissenting); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974), *cert. denied*, 421 U.S. 976, 95 S.Ct. 1976, 44 L.Ed.2d 467 (1975); *Moody v. Bache & Co., Inc.*, 570 F.2d 523, 527 n. 7 (5th Cir. 1978); Project, Recent Developments in Securities Law: Causes of Action Under Rule 10b-5, 28 Buffalo L.Rev. 503, 539-42 (1977); Jennings & Marsh at 1068-69 *Cf.* Note, Causation and Liability in Private Actions For Proxy Violations, 80 Yale L.J. 107 (1970).

[25] For example, an investor might purchase stock in a shipping venture involving a single vessel in reliance on a misrepresentation that the vessel had a certain capacity when in fact it

v. *Kohn*, 629 F.2d 705, 718 (2d Cir. 1980) (Meskill, J., dissenting). Absent the requirement of causation, Rule 10b-5 would become an insurance plan for the cost of every security purchased in reliance upon a material misstatement or omission. *See Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705, 718 (2d Cir. 1980) (Meskill, J., dissenting); *Globus* v. *Law Research Service, Inc.*, 418 F.2d 1276, 1292 (2d Cir. 1969), *cert. denied*, 397 U.S. 913, 90 S.Ct. 913, 25 L.Ed.2d 93 (1970); *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir.), *cert. denied sub nom.* 382 U.S. 811, 86 S.Ct. 23, 15 L.Ed.2d 60 (1965).

LoPatin and Share claim that the failure of TIS and the consequent economic loss of the plaintiff's investment is attributable to the materialization of risks described in the prospectus such as bad weather conditions and lack of spectator attendance at the racetrack. To prevail in their Rule 10b-5 action, the plaintiffs must establish that their economic loss was proximately caused by the fraudulent misstatements and omissions in the prospectus. This issue, the resolution of which is crucial to the plaintiff's recovery, was not submitted to the trier of fact. Hence the elements of the Rule 10b-5 claim were not established and the judgment against the defendants must be reversed.

[15] The plaintiffs urge that LoPatin, Share and H&M did not sufficiently raise the reliance issue and did not submit the "proper special issue to the court." It is helpful for counsel to assist the court by framing the issue in the very terms that pose it most objectively for the jury. However, so long as a party demands the submission of an

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had less capacity than was represented in the prospectus. However, the prospectus does disclose truthfully that the vessel will not be insured. One week after the investment the vessel sinks as a result of a casualty and the stock becomes worthless. In such circumstances, a fact-finder might conclude that the misrepresentation was material and relied upon by the investor but that it did not cause the loss.

omitted issue of fact and directs the court's attention to that issue, that party does not waive the right to a jury determination. Rule 49(a), Fed. R.Civ.P. *See Ford Motor Co.* v. *Dallas Power & Light Co.*, 499 F.2d 400, 407 & n. 11 (5th Cir. 1974); *Simien* v. *S.S. Kresge Co.*, 566 F.2d 551 (5th Cir. 1978).

H&M submitted to the court a proposed special issue phrased as follows:

> "Do you find from a preponderance of the evidence that the plaintiffs relied upon those matters in the T.I.S. prospectus which were false and misleading in purchasing T.I.S. securities?
>
> Answer "The did rely" or "They did not rely.

While the proposal did not discriminate between misstatement and omission in issues, it sufficiently demanded jury consideration of the reliance issue to require the submission of that issue.

When a fact question is not submitted to the jury, "each party waives his right to a trial by jury of the [fact] issue so omitted unless before the jury retires he demands its submission to the jury." Rule 49(a), Fed.R.Civ.P. *See Guidry* v. *Kem Manufacturing Co.*, 604 F.2d 320, 321, *supplementing on petition for rehearing*, 598 F.2d 402 (5th Cir. 1979), *cert. denied*, 445 U.S. 929, 100 S.Ct. 1318, 63 L.Ed.2d 763 (1980). Before the jury retired, H&M filed exceptions to the proposed special issues, adopted by LoPatin and Share with the trial court's permission, objecting to the failure to submit reliance and causation issues to the jury. Thus, the defendants did not waive their right to a jury determination of the reliance and causation issues.

The trial judge stated in the hearing on motions for judgment that the causation issue is "a matter of law" and that neither reliance nor causation is a proper issue to be submitted to the jury in this case. We disagree.

The trial court's failure to submit the reliance and causation issues to the jury requires us to grant a new trial. We, therefore, pretermit the myriad other issues raised by counsel save those likely to arise on remand.

IV

THE TEXAS SECURITIES ACT

The class also asserted a pendent claim based on Section 33 of the Texas Securities Act [TSA], article 581-33(A)(2), Tex.Rev.CivStat. (Supp. 1963). That statute creates liability on the part of "[a]ny person who . . . [o]ffers or sells a security . . . by means of any untrue statement of a material fact . . . [in favor of] the person buying the security from him." LoPatin, Share and H&M all contend that the Texas statute is inapplicable to them because they did not offer or sell a security. The jury determined that each of these defendants was a seller of securities under the TSA.

The trial court charged the jury as to the meaning of the term "seller" for purposes of TSA liability using the language of the Texas Supreme Court in *Brown* v. *Cole*, 155 Tex. 624, 291 S.W.2d 704 (Tex. 1956).[26] in *Brown* the Texas court drew upon the definition of the term "sell," now codified in article 581-4(E), Tex.Rev.Civ.Stat. (1957), as meaning "any act by which a sale is made. . . ." *Brown* v. *Cole*, 291 S.W.2d at 708.

[16] The Texas courts have interpreted the term "seller" in the TSA to include those who are not direct vendors, and thus not in strict privity with the claimant. *See* Bordwine, Civil Remedies Under the Texas Securities Laws, 8

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[26] "[Y]ou are instructed that under the Texas Blue Sky Law [the TSA] a person is a seller of a security if he forms any link in the chain of the selling process or if he performs any act by which a sale is made."

Hous.L. Rev. 657, 673 (1971); Bromberg, Civil Liability Under Texas Securities Act § 33 (1977) and Related Claims, 32 Sw.L.J. 867, 881 (1978) (pre-1977 decisions gave "seller" an "astoundingly broad meaning"). However, in *Stone* v. *Enstam*, 541 S.W.2d 473 (Tex.Civ.App.1976), the Texas court distinguished *Brown* v. *Cole* as a case involving an active negotiator whose efforts resulted in the sale and limited the term "seller" to the actual seller and one who acts as an agent for either the buyer or seller in carrying out the sale itself. 541 S.W.2d at 480. This decision limits the TSA to those who are actively engaged in the sale process and prevents it from reaching those who merely participate in preparing an offering.[27] *See* Bromberg, Civil Liability Under Texas Securities Act § 33 (1977) and Related Claims, 32 Sw.L.J. 867, 885-90 (1978).

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[27] We find further support for this construction of the Texas cases in the TSA's legislative history and analogy to the federal provisions on which the Texas statute was based. The comments to both the 1963 and 1977 amended versions of Section 33 of the TSA refer to Section 12 of the 1933 Act, 15 U.S.C. § 77*l*, which served as the basis for the drafting of the Uniform Securities Act, the model used in the 1963 and 1967 Texas enactments. *See* Bateman, Securities Litigation: The 1977 Modernization of Section 33 of the Texas Securities Act, 15 Hous.L.Rev. 839, 844-45 (1978); Bordwine, Civil Remedies Under Texas Securities Laws, 8 Hous.L.Rev. 657, 665 (1971). We have held that under Section 12 of the 1933 Act the term "seller" is limited "(i) to those in privity with the purchaser and (ii) to those whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place. Mere participation in the events leading up to the transaction is not enough." *Pharo v. Smith*, 621 F.2d 656, 667 (5th Cir. 1980). *See Lewis v. Walston & Co., Inc.*, 487 F.2d 617, 621 (5th Cir. 1973). We have refused to extend Section 12 to include aiders, abettors and controlling persons as sellers. *Croy v. Campbell*, 624 F.2d 709, 713 n. 5 (5th Cir. 1980). We have also formulated the test for a Section 12 seller in terms of proximate causation, *i. e.*, whether the injury to the plaintiff flowed directly and proximately from the actions of the defendant or whether the defendant was the motivating force behind the

There was no evidence here that LoPatin and Share actively participated in instigating the actual sales transactions to any member of the plaintiff class. Patently H&M did not. Indeed, the two class representatives who testified at trial bought their TIS securities on the open market and not from the corporate issuer. To include LoPatin, Share or H&M within Section 33 would throw a net of liability broader than that contemplated by the statutory language or the Texas decisions.[28] Thus, the evidence was insufficient to support the jury finding that these defendants were sellers under the TSA. The district judge should, therefore, have directed a verdict for LoPatin, Share and H&M on the Texas Securities Act claim.

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sale. *Hill York Corp. v. American International Franchises, Inc.*, 448 F.2d 680, 693 (5th Cir. 1971); *Croy v. Campbell*, 624 F.2d 709, 713 (5th Cir. 1980). *See Swenson v. Engelstad*, 626 F.2d 421 (5th Cir. 1980). We have focused on the circumstances surrounding the sales transaction itself to determine that a defendant is not a Section 12 seller if he did nothing to bring the sale about, *Pharo v. Smith*, 621 F.2d 656, 667 (5th Cir. 1980), or if, although involved in the actual sales negotiations, his participation was insufficient to make it a proximate cause of the transaction, *Croy v. Campbell*, 624 F.2d 709, 714 (5th Cir. 1980). *But see In re Caesars Palace Securities Litigation*, 360 F.Supp. 366, 378-83 (S.D.N.Y. 1973). *See generally* Jennings & Marsh at 1095-1100.

[28] Although LoPatin and Share might have been "controlling persons" of TIS, the issuer, and thus subject to liability under Section 15 of the 1933 Act, 15 U.S.C. § 77*o*, the pre-1977 version of the Texas Securities Act, which is applicable in this case, allows reference only to the scope of Section 12 of the 1933 Act. The comments accompanying the 1977 amendments to the TSA indicate that there was no liability for aiders, abettors and controlling persons under the pre-1977 version of the Texas statute.

V

EVIDENTIARY MATTERS

To assist in the new trial that must ensue, we discuss the principal evidentiary issues raised in this appeal.

A. Expert Testimony on Standards and Customs in the Securities Industry

[17] The court permitted plaintiff's expert witness, a lawyer, to testify concerning the interpretation given some of the prospectus boilerplate language in the securities industry.[29] The expert testified that the statement in the prospectus concerning the high degree of risk associated with the securities was standard language for a prospectus used in connection with the issuance of a new security. This testimony was relevant to proof of scienter on the part of defendants, *i. e.*, whether the customary treatment of the boilerplate language was such that the defendants, by including such language, were likely to have believed it would negate any misleading effects of the cost estimates. It was also relevant to the issue of materiality of the cost estimates in the prospectus.

This testimonial evidence had a "tendency to make the existence of .... [a] fact .... [consequent] to the determination of the action more probable or less probable than it would be without the evidence." Rule 401, Fed.R.Evid. It was based on technical knowledge that would assist the

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[29] We pretermit discussion of this expert's testimony concerning the due diligence that the defendants should have exercised to comply with the standards of the securities industry because, in relation to the jury's answers to interrogatories upon which the judgment against LoPatin, Share and H&M was based, the due diligence issue primarily concerned a party in whose favor judgment was rendered and against whom no appeal was taken. Contrary to defendants' contentions, we do not consider this testimony to have been prejudicial as to the jury's findings against LoPatin, Share and H&M.

trier of fact to understand the evidence or to determine a fact issue. Rule 702, Fed.R.Evid. *See generally* 11 Moore's Federal Practice § 702.10[1] (2d ed. Supp.1976). Even if it embraced an ultimate issue, it was not for that reason alone objectionable. Rule 704, Red.R.Evid. *See generally* 11 Moore's Federal Practice § 704.10 (2d ed. Supp.1976). It was, therefore, properly admitted. We do not, of course, assess each question and answer but weigh the testimony on the whole.

B. Written Comments by Outside Director

[18] The notes taken at a January, 1970, TIS board meeting by an outside director, who at the time of the introduction of the notes into evidence was a defendant, were admitted over a hearsay objection by the defendants, presumably as admissions against him. Although the notes may have been admissible against the outside director defendant, the trial court should have instructed the jury as to their inadmissibility against LoPatin, Share and H&M. Once the outside director was no longer a party, a directed verdict having been rendered in his favor, the notes became wholly inadmissible. As to LoPatin, Shares and H&M, the notes are double hearsay, a report not under oath concerning what was said by a party not under oath, hence inadmissible. Rule 802, Fed.R.Evid. We express no opinion concerning the admissibility of the outside director's testimony at a new trial concerning what was said by a party to the proceedings. *Compare* Rules 801 and 803(3), Fed.R.Evid. (hearsay exception for state of mind).

C. Evidence of Events Occurring After the Class Period

[19] The defendants objected to the admission of evidence concerning events that took place after the end of the class period. Of course, evidence that LoPatin and Share failed to fulfill corporate fiduciary duties was not relevant to the securities claim. Unless some reason for the admissibility of this evidence is shown, it should be excluded.

[20] The fact that TIS gave a lien to Holloway Sand & Gravel Co. in mid-1970 to secure the debt owed to the contractor for construction of the speedway bears on the accuracy of the Use of Proceeds section of the prospectus to the extent that it establishes the amount for which the contractor remained uncompensated from the proceeds of the offering. Although the special issues put to the jury necessarily focused on the accuracy of the Use of Proceeds section as of October 30, 1969, the lien created after the class period was relevant to establish that the cash available after payment of construction costs was misstated in the prospectus. The SEC Form 10K report for the fiscal year ending November 30, 1969, was based on financial data unavailable until March, 1970. However, the 10K report established the true financial picture of the company during the period at issue, the class period. It is admissible as a record of regularly conducted activities, *i. e.*, business records, Rule 803(6), Fed.R.Evid., if a proper foundation is laid. If admissible, it is relevant, but the court should instruct the jury concerning the limited purpose for which it may be considered.

D. Other Memoranda

The plaintiffs introduced the deposition of the TIS general manager and construction supervisor to establish that he had not been consulted as to the figures used in the Use of Proceeds section of the Prospectus. He testified that, had he been consulted, he would have questioned the accuracy of the figures in the light of his own June, 1969, estimates. The defendants attempted to introduce other parts of the deposition dealing with a visit by a representative of the underwriters to the construction supervisor in October, 1969, in which the cost figures were apparently discussed, as well as a memorandum prepared by the underwriters' representative concerning his meeting with the construction supervisor which the plaintiffs had introduced at the deposition as an exhibit.

[21] The defendant's offer was improperly rejected. When part of a recorded statement is introduced by a party, an adverse party may require him to introduce any other part of the recorded statement that ought in fairness be considered with it. Fed.R.Evid. 106. *See* 21 C. Wright & K. Graham, Federal Practice and Procedure: Evidence § 5073, at 350 (1977). The rule is made specifically applicable to depositions by Fed.R.Civ.P. 34(a)(4). *See* 8 C. Wright & A. Miller, Federal Practice and Procedure: Civil § 2148 (1970). Thus, the defendants were entitled to introduce other parts of the deposition dealing with the underwriters' consultation with the construction supervisor regarding the costs of construction.

The memorandum written by the underwriters' representative reporting on his meeting with the TIS construction supervisor was, of course, hearsay. Objections to the admissibility of evidence taken at the deposition may be made at the trial when the deposition is introduced into evidence. Fed.R.Civ.P. 32(b). If a proper foundation is laid at the new trial, the memorandum might be admissible under the "business records" exception to the hearsay rule. Fed.R.Evid. 803(6).

The admission of other items of evidence is objected to by the defendants. We do not review these in detail because the focus on retrial and the purposes for which the evidence is offered may well be different.

VI

MEASURE OF DAMAGES

[22] Should liability be established, the measure of damages must be considered.[30] The amount of damages is a

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[30] Our disposition of the case allows us to pretermit the issue raised in this appeal whether the trial court improperly determined damages without a separate trial of that issue in light of the statements in the trial court's May 25, 1976, order correcting,

jury issue although the services of a special master[31] or the testimony of an expert witness[32] in assembling data and making computations may be particularly helpful in a class action. The ultimate question, however, is how much damage did the defendants' fraudulent misstatement or omission cause each individual plaintiff.

[23] "The principle is well settled that federal law, rather than state law, governs the construction of all aspects of Rule 10b-5, such as . . . the proper measure of damages, . . . and whether prejudgment interest is recoverable [*Wolf v. Frank*, 477 F.2d 467, 479 (5th Cir.), *cert. denied*, 414 U.S. 975, 94 S.Ct. 287, 38 L.Ed.2d 218 (1973)]. . . ." *Alley v. Miramon*, 614 F.2d 1372, 1381 n.18 (5th Cir. 1980). The Supreme Court has indicated that Section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a), establishes the proper measure of damages in a Rule 10b-5 case. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 155, 92 S.Ct. 1456, 1473, 31 L.Ed.2d 741, 762 (1972). *See Dupuy v. Dupuy*, 551 F.2d 1005, 1024 (5th Cir.), *cert. denied*, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977). *See generally* 5B A. Jacobs, The Impact of Rule 10b-5 § 260.03[a], at 11-15 (Supp.1980). That statute limits the claimant's recovery to an amount not "in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb(a). The proper measure of the actual damages recoverable by the Rule 10b-5 plaintiff is "the least formulated and the least reported upon" of all issues raised by a Rule 10b-5 claim. Jacobs, The Measure of Damages in Rule 10b-5 Cases, 65 Geo. L.J. 1095 (1977).

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modifying and supplementing the class action order, that appear to mandate a bifurcated trial of the liability and damages issues.

[31] Rule 53, Fed.R.Civ.P. *See generally* 5A Moore's Federal Practice ¶ 53.05[2], at 53-61 – 53-62 & n. 53 (2d ed. Supp. 1980) (referral of damages issue to special master).

[32] Rule 706, Fed.R.Evid. *See generally* 11 Moore's Federal Practice § 706 (2d ed. Supp. 1976).

The district court determined the claimants' losses as the price paid to acquire the TIS securities initially minus the proceeds received on any sale of those securities. TIS securities still held by class members were considered worthless. Thus, the court measured damages to the class members on the basis that each plaintiff who had not sold the securities purchased suffered the loss of his total investment in consequence of the defendants' deceit, calling this a rescissional basis for computing damages. Denominating the remedy "rescissional," however, does not solve the underlying problems in fixing the amount of damages.

"The cases are uniform in stating that one remedy which may be available to a defrauded plaintiff under Rule 10-b5 is to seek rescission of the transaction and ... recover the amount paid for the securities, if he is a buyer...." Jenkins and March at 1085. The "rescissional damages for a plaintiff buyer equal the fair value of what the plaintiff gave up, measured at the time of the fraudulent purchase, *minus the fair value of what the plaintiff received, measured at the time of the sale.*" Jacobs, The Measure of Damages in Rule 10b-5 Cases, 65 Geo. L.J. 1093, 1118-19 (1977) (emphasis added).

Rescission is the avoidance or undoing of the transaction. Its purpose is to return the defrauded purchaser to the status quo ante; it contemplates the return of the injured party to the position he occupied before he was wrongfully induced to enter the transaction. *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1342 (9th Cir. 1976) (Sneed, J., concurring); 5B A. Jacobs, The Impact of Rule 10b-5 § 260.03[c][vi], at 11-47 and 11-49 (Supp.1980).

[24, 25] Use of the rescissional measure is usually limited to cases involving either privity between plaintiff and defendant or some specific fiduciary duty owed by brokers to their customers. *See* Note, The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities, 26 Stan.L.Rev. 371, 376 (1974); Mullaney, Theories of

Measuring Damages in Security Cases and the Effects of Damages on Liability, 46 Fordham L.Rev. 277, 285 (1977); Jacobs, The Measure of Damages in Rule 10b-5 Cases, 65 Geo.L.J. 1093, 1110 (1977). There are patent difficulties inherent in the application of this measure to a transaction between a securities purchaser and one who was not the seller of the securities.

Section 12(2) of the 1933 Act, 15 U.S.C. § 77*l*(2), provides as a remedy for its violation that the seller is liable to the person *purchasing from him* for the "consideration paid for such security with interest thereon, upon the tender of such security . . . ." That statute permits rescission if there is a degree of privity between the claimant and the defendant.[33] However, if the purchaser did not buy from the defendant or if he no longer owns the security, then the parties cannot be returned to the status quo ante and Section 12(2) provides that damages, not rescission, is the proper remedy.

None of the defendants was alleged or proved to have been in privity with the plaintiffs. Moreover, to adopt without qualification the remedy permitted under Section 12(2) in a Rule 10(b)-5 action would be inequitable, for the plaintiffs in this case chose not to proceed under Section 12(2), presumably because of the defenses available to such an action, including the one year statute of limitations, Section 13 of the 1933 Act, 15 U.S.C. § 77m, and the procedural limitations, such as the privity requirement applicable to a Section 12(2) claim.

If the Rule 10b-5 claimants have purchased securities on the open market and did not deal face to face with the defendants. the price the purchasers paid did not accrue directly to the defendants. The defendants cannot, in effect, return

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[33] *See* the discussion of the Section 12(2) privity requirement and the extent of permissible deviation from that requirement in note 27, *supra*.

the purchase price that they never received or rescind a transaction to which they were not party. *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1341-43 (9th Cir. 1976) (Sneed, J., concurring).

Moreover, the rescissional measure permits the defrauded securities buyer to place upon the defendant the burden of any decline in the value of the securities between the date of purchase and the date of sale even though only a portion of that decline may have been proximately caused by the defendant's wrong. The decline in the value of the securities in this case may have also resulted from other factors like market forces and events unrelated to the deceit that had an economic effect on the enterprise, such as weather, degree of spectator participation and construction problems. Under these circumstances, the rescissional measure is unjust insofar as it compensates an investor for the nonspecific risks which he assumes by entering the market. Note, The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities, 26 Stan.L.Rev. 371, 376 (1974); *Green v. Occidental Petroleum Corp.*, 541 F.2d at 1343 (Sneed, J., concurring). Losses thus accruing have no relation to either the benefits derived by the defendants from the fraud or to the blameworthiness of their conduct.

The entire loss to the defrauded buyer from the decline in the value of the securities purchased cannot be automatically attributed to the defendants' deceit unless this court were to adopt a theory of damages that views the entire loss as resulting from the fraud because, "but for" the deceit, the buyer would not have purchased, and hence would have suffered no loss. The private cause of action under Rule 10b-5 "is essentially a tort claim. . . . Thus, the private complainant must show not only a violation of the rule, *i.e.*, an untrue statement or material omission in connection with the sale of a security, but must also show that the omission or untrue statement resulted in or *caused* the complainant's damage."

Moody v. Bache & Co., Inc., 570 F.2d 523, 527 (5th Cir. 1978) (emphasis added).

The proper measure of damages to reflect the loss proximately caused by the defendants' deceit is the out-of-pocket rule. That rule is the traditional measure of damages in a Rule 10b-5 action, 5B A. Jacobs, The Impact of Rule 10b-5 § 260.03[c][ii], at 11-23 (Supp.1980), applied by the Supreme Court in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 155, 92 S.Ct. 1456, 1473, 31 L.Ed.2d 741, 762 (1972), as the proper measure of damages in the case of the defrauded seller under Rule 10b-5. The out-of-pocket measure is also the usual rule of recovery in the common law action for deceit from which Rule 10b-5 derives.[34]

We have applied the out-of-pocket measure in actions brought under Rule 10b-5 to allow recovery for an amount of damages equal to the difference between the price paid and the "real" value of the security, *i.e.*, the fair market value absent the misrepresentations, at the time of the initial purchase by the defrauded buyer.[35]

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[34] *See* Restatement (Second) of Torts § 549 & Comment b (1977); W. Prosser, The Law of Torts § 110, at 733-34 (4th ed. 1971); 1 F. Harper & F. James, The Law of Torts § 7.15, at 591 (1956).

[35] *See Alley v. Miramon*, 614 F.2d 1372, 1387 (5th Cir. 1980) (dicta); *Nor-Tex Agencies, Inc. v. Jones*, 482 F.2d 1093, 1097 (5th Cir. 1973), *cert. denied*, 415 U.S. 977, 94 S.Ct. 1563, 39 L.Ed.2d 873 (1974); *Wolf v. Frank*, 477 F.2d 467, 478 (5th Cir.), *cert. denied*, 414 U.S. 975, 94 S.Ct. 287, 38 L.Ed.2d 218 (1973). *See also Dupuy v. Dupuy*, 551 F.2d 1005, 1024-25 (5th Cir.) *cert. denied*, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977). *See generally* 5B A. Jacobs, The Impact of Rule 10b-5 § 260.03[c][ii], at 11-25 & n. 8 (Supp. 1980). *Compare* our dicta in *John R. Lewis Inc. v. Newman*, 446 F.2d 800, 805 (5th Cir. 1971); *Woolf v. S. D. Cohn & Co.*, 515 F.2d 591, 605 (5th Cir. 1975), *vacated and remanded*, 426 U.S. 944, 96 S.Ct. 3161, 49 L.Ed.2d 1181 (1976).

The use of the out-of-pocket measure of damages creates, of course, valuation problems in the determination of the recovery to be awarded to each plaintiff. However, as Judge Sneed recognized in his concurring opinion in *Green v. Occidental Petroleum Corp.*, "[w]rongdoing defendants should not be mulcted to make simple the management of a class proceeding under rule 10b-5." 541 F.2d at 1343.

[26] Neither is the application of the out-of-pocket measure too complex to be applied in this case. The use of the out-of-pocket rule will require that a "true" or "real" value, *i. e.*, the value the security would have had absent the misrepresentation, be established for each date on which members of the class purchased during the ninety-day class period.[36] Once those values are obtained, possibly with the help of expert witnesses or a special master, then the determination of each individual plaintiff's recovery becomes a simple matter of subtraction of the "true" value of the security on the date of the plaintiff's purchase from the purchase price paid by the plaintiff on that date. The issue of damages is thus an individual matter to be determined separately for each member of the plaintiff class.

VII

CONTRIBUTION AMONG RULE 10b-5 DEFENDANTS

The defendants sought contribution from those co-defendants who had compromised the plaintiffs' claims and entered into settlement agreements approved by the trial

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[36] Judge Sneed suggests that a "value line" be established that would indicate the true value of the security on each day of the class period. *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1344 (9th Cir. 1976) (Sneed, J., concurring). *See* Mullaney, Theories of Measuring Damages in Security Cases and the Effects of Damages on Liability, 46 Fordham L.Rev. 277, 293 (1977).

court to which LoPatin, Share and H&M were not parties. The district court denied contribution but gave a credit in its final judgment against LoPatin, Share and H&M for the amounts received in settlement.

Whether one person who commits a violation of Rule 10b-5 may seek contribution from others who have also participated in the perpetration of the fraud is an issue that has not been decided by this circuit. *See Woolf v. S. D. Cohn & Co.*, 515 F.2d 591, 605 & n. 7 (5th Cir. 1975) (recognizing without deciding the issue), *vacated and remanded*, 426 U.S. 944, 96 S.Ct. 3161, 49 L.Ed.2d 1181 (1976). *But see* our dicta in *Kuehnert v. Texstar Corp.*, 412 F.2d 700, 705 n. 7 (5th Cir. 1969).

A number of district courts[37] and two circuit courts[38] have recognized the right to contribution in Rule 10b-5 actions. The commentators are in agreement with this result.[39]

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[37] *See Stratton Group, Ltd. v. Sprayregen*, 466 F.Supp. 1180, 1185 (S.D.N.Y. 1979); *Marrero v. Abraham*, 473 F.Supp. 1271, 1276 (E.D.La. 1979); *McLean v. Alexander*, 449 F.Supp. 1251, 165-67 (D.Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979); *Index Fund, Inc. v. Hagopian*, 417 F.Supp. 738, 746 & n. 6 (S.D.N.Y. 1976); *B&B Investment Club v. Kleinert's, Inc.*, 391 F.Supp. 720, 724 (E.D.Pa. 1975); *Odette v. Shearson, Hammill & Co., Inc.*, 394 F.Supp. 946, 958-59 (S.D.N.Y. 1975); *Muth v. Dechert, Price & Rhoads*, 391 F.Supp. 935, 939 (E.D.Pa. 1975); *Alexander & Baldwin, Inc. v. Peat, Marwick, Mitchell & Co.*, 385 F.Supp. 230, 239-40 (S.D.N.Y. 1974); *Liggett & Myers Inc. v. Bloomfield*, 380 F.Supp. 1044, 1046 (S.D.N.Y. 1974); *Globus, Inc. v. Law Research Service, Inc.*, 318 F.Supp. 955 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.*, 404 U.S. 941, 92 S.Ct. 286, 30 L.Ed.2d 254 (1968), *aff'd in part and vacated in part*, 435 F.2d 1223 (10th Cir. 1970).

[38] *Heizer Corp. v. Ross*, 601 F.2d 330 (7th Cir. 1979); *Globus, Inc. v. Law Research Service, Inc.*, 318 F.Supp. 955 (S.D.N.Y. 1970), *aff'd* 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.*, 404 U.S. 941, 92 S.Ct. 286, 30 L.Ed.2d 254 (1971).

[39] See Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnifica-

[27] Because the Rule 10b-5 action is implied in a federal statute, the right to contribution under Rule 10b-5 is determined by federal law.[40]

Early common law recognized no right to contribution[41] among intentional joint tortfeasors, while early American courts established the general rule of no contribution between concurrent wrongdoers, whether negligent or intentional.[42] The rule against contribution by negligent tortfeasors was later gradually eroded on the equitable basis that it was unfair to require one person to bear the entire loss of an injury that he had not alone caused or to permit

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tion, and Contribution, 120 U.Pa.L.Rev. 597 (1972); *Fisher*, Contribution in 10b-5 Actions, 33 Bus.Law 1821 (1978); 5B A. Jacobs, The Impact of Rule 10b-5 § 264.02[c] (Supp. 1980); Jennings & Marsh at 1088.

[40] "The principle is well settled that federal law, rather than state law, governs the construction of *all* aspects of Rule 10b-5 . . ." *Alley v. Miramon*, 614 F.2d 1372, 1381 n. 18 (5th Cir. 1980) (emphasis added), including whether a contribution action will lie against co-defendants in the Rule 10b-5 action. *See Heizer Corp. v. Ross*, 601 F.2d 330, 331 (7th Cir. 1979). *See also* 5B A. Jacobs, The Impact of Rule 10b-5 § 264.02[c], at 11-328 (Supp. 1980); Fischer, Contribution in 10b-5 Actions, 33 Bus. Law. 1821, 1827 (1978).

[41] Contribution differs from indemnification, a risk-shifting rule which transfers liability from one tortfeasor to another who, either by express or implied contract, is responsible. W. Prosser, The Law of Torts § 51, at 310 (4th ed. 1971). *Compare* Restatement (Second) of Torts § 886A *with* § 886B (1977). *See* Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution, 120 U.Pa.L.Rev. 597, 647 (1972); Fischer, Contribution in 10b-5 Action, 33 Bus.Law. 1821, 1821-22 (1978).

[42] W. Prosser, The Law of Torts § 50, at 306 (4th ed. 1971); Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution, 120 U.Pa.L.Rev. 597, 648 (1972).

the injured person for whatever motive, benign or invidious, to select the one defendant from whom he wished to recover. The no-contribution rule was, therefore, modified by statute or decision to require contribution where the injury was caused by negligence.[43]

[28] American state courts continue to deny a right to contribution in favor of any tortfeasor who intentionally causes the harm. Restatement (Second) of Torts § 886A(3) (1977). *See* Uniform Contribution Among Tortfeasors Act § 1(c) (1955); W. Prosser, The Law of Torts § 50, at 308 (4th ed. 1971). "The basis of the rule is the old one that the courts will not aid one who has deliberately done harm, so that no man can be permitted to found a cause of action on his own intentional tort." Restatement (Second) of Torts § 886A(3), Comment j (1977).

[29] In addition to the tort rule disallowing contribution among intentional wrongdoers, another justification advanced to support the denial of contribution among Rule 10b-5 defendants is the hypothesis that disallowance of any shifting of part of the loss sustained by the Rule 10b-5 defendant to the other participants in the fraud creates a greater deterrent to conduct violative of the Rule. This

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[43] Only a handful of American jurisdictions have judicially overruled the no-contribution rule to allow contribution among negligent, but not intentional, tortfeasors. *See* Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution, 120 U.Pa.L.Rev. 597, 648 (1972); W. Prosser, The Law of Torts § 50, at 306-307 (4th ed. 1971). However, many states have statutes favoring contribution in varying degrees. Fischer, Contribution in 10b-5 Actions, 33 Bus.Law. 1821, 1825 & n. 19 (1978); W. Prosser, The Law of Torts § 50, at 307 (4th ed. 1971). *See* 1 F. Harper & F. James, The Law of Torts § 10.2, at 719 & n. 25 (1956). By 1935 statute, contribution may be demanded by an intentional tortfeasor in England. Law Reform (Married Women and Tortfeasors) Act, 25 & 26 Geo. V, c. 30, s. 6(1)(c). *See* 1 F. Harper & F. James, The Law of Torts § 10.2, at 715 & n. 2 (1956).

theory does not consider the alternative possibility that the disallowance of contribution fails to deter those co-conspirators who are not likely to be named as defendants in the Rule 10b-5 action.[44] Assuming that an actor consciously takes the possible consequence of a civil action into account when he is deciding whether or not to commit a fraud, he may either be deterred by fear of total liability or encouraged by a knowledge that another co-actor may be the only one sued and thus may bear the entire fault.

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[44] "[D]eterrence favors contribution. Contribution tends to increase the diligence of potential defendants because each of them knows that he will be responsible for a portion of the damages, whether or not the defrauded investor names him in the lawsuit." 5B A. Jacobs, The Impact of Rule 10b-5 § 264.02[c], at 11-329 (Supp. 1980). For cases supporting the view that the allowance of contribution furthers the deterrence objective, *see Heizer Corp. v. Ross*, 601 F.2d 330, 332 (7th Cir. 1979); *Marrero v. Abraham*, 473 F.Supp. 1271, 1278 (E.D.La. 1979); *Odette v. Shearson, Hammill & Co., Inc.*, 394 F.Supp. 946, 958 (S.D.N.Y. 1975); *Globus, Inc. v. Law Research Service, Inc.*, 318 F.Supp. 955, 958 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.*, 404 U.S. 941, 92, S.Ct. 286, 30 L.Ed.2d 254 (1971).
The deterrence rationale was advanced by this court in another area of federal law in *Wilson P. Abraham Construction Corp. v. Texas Industries, Inc.*, 604 F.2d 897 (5th Cir. 1979), *cert. granted sub nom.*, U.S. , 101 S.Ct. 351, 66 L.Ed.2d 351 (Nov. 4, 1980), holding that defendants found liable under the federal antitrust laws may not seek contribution from their co-conspirators. In that case we determined that the greater deterrent effect is obtained by the imposition of sole liability for the treble damages provided by the antitrust laws upon the violator who is sued. 604 F.2d at 905. We distinguished those case allowing contribution under Rule 10b-5 of the securities laws, *see* note 37, *supra*, by noting that several express liability provisions of the 1933 and 1934 Acts provide specifically for contribution, thus, justifying contribution under Rule 10b-5 by the principle that the securities laws should be read *in pari materia*. 604 F.2d at 903.

A rule allowing contribution among Rule 10b-5 defendants is "buttressed by the fact that of the seven express civil remedies provided in the Securities Act of 1933 [§§ 11, 12 and 15, 15 U.S.C. §§ 77k, 77*l* and 77*o*] and the Securities Exchange Act of 1934, [§§ 9, 16, 18 and 20, 15 U.S.C. §§ 78i, 78p, 78r and 78t] three of those provide expressly for contribution." *Heizer Corp. v. Ross*, 601 F.2d 330, 332 (7th Cir. 1979).[45]

The common law rule precluding intentional wrongdoers from seeking contribution developed long before the evolution of multiparty litigation involving class plaintiffs, numerous defendants, vast monetary claims, lengthy trials and enormous litigation costs. The disallowance of contribution in the context of such modern multiparty litigation encourages the presentation of enormous claims against numerous defendants in the hope that at least some of those named will, merely to avoid the heavy cost of litigation, pay a settlement amount rather than defend the action. Thus, the no-contribution rule promotes a rush to settlement whereby certain defendants can purchase freedom from litigation and the ultimate court judgment, simultaneously providing the plaintiffs with funds to finance the continuation of the suit against the non-settling defendants. Moreover, the settling defendants may well extricate themselves from the litigation in exchange for relatively small settlement amounts, leaving the non-settling defendants to bear a much larger liability in the form of the final court judgment.

Persons injured by the willful torts or deceit of others are entitled to full redress but should not be able to play one defendant against another as a gambit. Although the law favors compromise as a means of ending litigation, the type of settlement that is reached on the basis of the denial of

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[45] See Section 11(f) of the 1933 Act, 15 U.S.C. § 77k(f); Sections 9(e) and 18(b) of the 1934 Act, 15 U.S.C. § 78i(e) and § 78r(b).

contribution neither terminates the litigation nor furthers the goals of efficient court administration.

In articulating its reasons for requiring contribution among negligent joint tortfeasors in admiralty, the Supreme Court stated, "a 'more equal distribution of justice' can best be achieved by ameliorating the common-law rule against contribution which permits a plaintiff to force one of two wrongdoers to bear the entire loss, though the other may have been equally or more to blame." *Cooper Stevedoring Co. v. Fritz Kopke, Inc.*, 417 U.S. 106, 111, 94 S.Ct. 2174, 2177, 40 L.Ed.2d 694, 700 (1974). We conclude that a rule permitting contribution provides an equitable result that sufficiently satisfies the objective of deterrence under the securities laws.

VIII

ATTORNEY'S FEES AND PREJUDGMENT INTEREST

[30] In *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975), the Supreme Court expressed strong support for the "American Rule" which prohibits the imposition of attorney's fees except when authorized by statute or by traditionally recognized exceptions. There is no statutory provision awarding attorney's fees to the successful party in an action brought under Rule 10b-5. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 211 n. 30, 96 S.Ct. 1375, 1389 n. 30, 47 L.Ed.2d 668, 687 n. 30 (1976); *Van Alen v. Dominick & Dominick, Inc.*, 560 F.2d 547, 553 (2d Cir. 1977).

[31] Of the several situations recognized in *F. D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129-30, 94 S.Ct. 2157, 2165, 40 L.Ed.2d 703, 713 (1974), in which a deviation from the general principle that each party should bear the cost of his own legal representation is permitted, the trial court in this case relied upon the "bad faith" exception. *See e. g., Newman v. Piggie*

Park Enterprises, Inc., 390 U.S. 400, 402 n. 4, 88 S.Ct. 964, 966 n. 4, 19 L.Ed.2d 1263, 1266 n. 4 (1968). The "bad faith" exception permits an award of attorneys fees to the successful party if an unfounded action or defense is brought or maintained for oppressive reasons, 6 Moore's Federal Practice ¶ 54.77[2], at 1709 (2d ed. Supp. 1976), or if the "opponent has acted in bad faith, vexatiously, wantonly, or for oppresive reasons. . . ." *F. D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. at 129, 94 S.Ct. at 2165, 40 L.Ed.2d at 713; *Hall v. Cole*, 412 U.S. 1, 5, 93 S.Ct. 1943, 1946, 36 L.Ed.2d 702, 707 (1973). The underlying rationale of "fee shifting" pursuant to the "bad faith" exception is punitive. *Hall v. Cole*, 412 U.S. at 5, 93 S.Ct. at 1946, 36 L.Ed.2d at 707. Because punitive damages are not available in a 10b-5 action,[46] the bad faith or vexatious conduct inherent in the fraudulent acts that constituted the cause of action itself cannot be the basis for an attorney's fees award under the bad faith exception. *Straub v. Vaisman & Co., Inc.*, 540 F.2d 591, 599 (3d Cir. 1976). *See* Note Recovery of Attorneys' Fees Under Rule 10b-5, 53 Notre Dame Law. 320, 338-42 (1977) (discussing *Straub* holding). The bad faith conduct must occur during the litigation process itself. See *Nemeroff v. Abelson*, 620 F.2d 339, 348 (2d Cir. 1980).

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[46] Section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a), denying recovery in excess of actual damages, is applicable to claims for damages under Rule 10b-5. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 155, 92 S.Ct. 1456, 1473, 31 L.Ed.2d 741, 762 (1972). That section precludes recovery for punitive damages. *Byrnes v. Faulkner, Dawkins & Sullivan*, 550 F.2d 1303, 1313 (2d Cir. 1977); *Straub v. Vaisman and Co., Inc.*, 540 F.2d 591, 599 (3d Cir. 1976); *Gould v. American-Hawaiian S. S. Co.*, 535 F.2d 761, 784 (3d Cir. 1976); *Carras v. Burns*, 516 F.2d 251, 259 (4th Cir. 1975); *deHaas v. Empire Petroleum Co.*, 435 F.2d 1223 (10th Cir. 1970). *See Aboussie v. Aboussie*, 441 F.2d 150, 157 (5th Cir. 1971), *rev'd and remanded on other grounds on rehearing*, 446 F.2d 56 (5th Cir. 1971). *See generally* Jacobs, The Measure of Damages in Rule 10b-5 Cases, 65 Geo.L.J. 1093, 1147-48 (1977).

The trial judge found bad faith in this case that had nothing to do with the conduct of the litigation proceedings.[47] It was based only on the conduct of the defendants which gave rise to the cause of action itself. Unless the further proceedings are conducted in a vexatious manner, attorney's fees should not be allowed.

[32] On the question of awarding prejudgment interest in a 10b-5 case, this court held in *Wolf v. Frank*, 477 F.2d 467, 479 (5th Cir.) *cert. denied*, 414 U.S. 975, 94 S.Ct. 287, 38 L.Ed.2d 218 (1973), that federal law governs. The federal standard is one of fairness and its application rests within the District Court's sound discretion.[48] Upon retrial the district court may find it appropriate again to award prejudgment interest.

For these reasons the judgment is REVERSED and the case is REMANDED for further proceedings consistent with this opinion.

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[47] In the hearing on motions for judgment, held on October 16, 1979, the court indicated that the bad faith on which the attorney's fees award was based did not occur during the pendency of the proceedings and was not a bad faith finding "over and above" the findings made by the jury. Moreover, during the December 13, 1979, hearing on the motion for stay of execution of judgment, the trial judge clarified his "bad faith" finding by stating that the acts of bad faith were not committed by the lawyers involved in this litigation.

[48] *See Blau v. Lehman*, 368 U.S. 403, 414, 82 S.Ct. 451, 457, 7 L.Ed.2d 403, 411 (1962); *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 516 F.2d 172, 191 (2d Cir. 1975), *rev'd on other grounds*, 430 U.S. 1, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977); *Occidental Life Insurance Co. v. Pat Ryan & Ass... Inc.*, 478 F.2d 1255, 1268-69 (4th Cir.), *cert. denied*, 419 U.S. 1025, 95 S.Ct. 499, 42 L.Ed.2d 297 (1974); *Wessel v. Buhler*, 437 F.2d 279, 284 (9th Cir. 1971); *Norte & Co. v. Huffines*, 416 F.2d 1189, 1191-92 (2d Cir. 1969), *cert. denied sub nom.*, 397 U.S. 989, 90 S.Ct. 1121, 25 L.Ed.2d 396 (1970). *See also* Jacobs, The Measure of Damages in Rule 10b-5 Cases, 65 Geo.L.J. 1093, 1160 (1970) (prejudgment interest available in a 10b-5 case).

HUDDLESTON v. HERMAN & MacLEAN

Ralph E. HUDDLESTON and Chester E. Bradley, Jr., Individually and as designated Class Representatives, Plaintiffs-Appellees,

v.

HERMAN & MacLEAN, etc., et al., Defendants,

Herman & MacLean, Certified Public Accountants, a partnership, and Lawrence A. LoPatin, Leslie Share, Defendants-Appellants.

No. 79-3712.

United States Court of Appeals,
Fifth Circuit.
Unit A

July 13, 1981.

Appeals from the United States District Court for the Northern District of Texas; William M. Taylor, Jr., Judge.

ON PETITION FOR REHEARING
AND SUGGESTION FOR
REHEARING EN BANC

(Opinion 5 Cir. 1981, 640 F.2d 534)

BEFORE WISDOM, RUBIN and SAM D. JOHNSON, Circuit Judges:

ALVIN B. RUBIN, Circuit Judge:

The Petition for Rehearing is DENIED and no member of this panel nor Judge of this Administrative Unit in regular active service having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16; Fifth Circuit Judicial Council Resolution of January 14, 1981), the suggestion for Rehearing En Banc is DENIED.

Subparts B and C of Section V of the opinion are changed to read as follows:

B. Written Comments by Outside Director

[18] The notes taken at a January, 1970, TIS board meeting by an outside director, who at the time of the introduction of the notes into evidence was a defendant, were admitted over a hearsay objection by the defendants, presumably on the basis that they were admissible against him as admissions against interest. If this was the basis, the trial court should have instructed the jury that they were inadmissible against LoPatin, Share and H&M. Once the outside director was no longer a party, a directed verdict having been rendered in his favor, the notes were no longer admissions of a party. In the absence of any other basis for their use, the notes are double hearsay as to LoPatin, Share and H&M, for they were not under oath and they concerned what was said by a party not under oath. Rule 802, Fed.R. Evid. We express no opinion concerning the admissibility of the notes under Rule 803(1), Fed.R.Evid., as statements describing or explaining an event made while the declarant was perceiving it or immediately thereafter, if a proper foundation is laid. Neither do we rule upon the admissibility at a new trial of the outside director's testimony concerning what was said by a party to the proceedings. *Compare* Rules 801 and 803(3), Fed.R.Evid. (hearsay exception for state of mind).

C. Evidence of Events Occurring After the Class Period

[19] The defendants objected to the admission of evidence concerning events that took place after the end of the class period. Of course, evidence that LoPatin and Share failed to fulfill corporate fiduciary duties was not relevant to the securities claim. Unless some adequate basis for the admissibility of this evidence is established, it should be excluded.

[20] The fact that TIS gave a lien to Holloway Sand & Gravel Co. in mid-1970 to secure the debt owed to the con-

tractor for construction of the speedway bears on the accuracy of the Use of Proceeds section of the prospectus to the extent that it establishes the amount for which the contractor remained uncompensated from the proceeds of the offering. Although the special issues put to the jury necessarily focused on the accuracy of the Use of Proceeds section as of October 30, 1969, the lien created after the class period was relevant to establish that the cash available after payment of construction costs was misstated in the prospectus. The SEC Form 10K report for the fiscal year ending November 30, 1969, was based on financial data unavailable until March 1970. However, the 10K report established the financial position of the company during the class period. Portions of it may be admissible as a record of regularly conducted activities, *i. e.*, business records, Rule 803(6), Fed.R.Evid., if a proper foundation is laid. It may be difficult or impossible to establish that the report in toto is admissable because the Rule requires that the memorandum be made "at or near the time" of the event it describes. Rule 803(6), Fed.R.Evid. If its admissibility is established, the court should instruct the jury concerning the limited purpose for which it may be considered.

C-1

IN THE

United States District Court

FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

HON. W. M. TAYLOR, JR.

Civil Action No. 3-6677-C

FINAL JUDGMENT

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR.,
Individually and as Designated Class Representatives,

Plaintiffs,

v.

HERMAN & MACLEAN, Certified Public Accountants,
a Partnership,
SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation,
LAWRENCE H. LOPATIN, LESLIE SHARE, GEORGE C. KAWAMOTO
and LEO B. MARGOLIAN,

Defendants,

This class action having come before the Court for trial by jury on Monday, June 13, 1979 under its former style of *David M. Kemp, et al., plaintiffs, and Howard V. Tygrett, Jr., as Trustee for Texas International Speedway, Inc., plaintiff-intervenor vs. Ladenburg, Thalmann & Co., et al., defendants;* and

It further appearing that on Wednesday, June 20, 1979 the case against defendants Dan Holloway and Holloway Sand & Gravel Co., Inc. (hereinafter the "Holloway defendants") was severed pending final approval by the Court after notice to the designated class of a proposed settlement consisting of a fifty thousand dollar ($50,000) payment in satisfaction of all claims asserted the Holloway defendants in this class action and the related action entitled *Talbot*

Rain, as Trustee for Texas International Speedway, Inc. v. *American Raceways, Inc., et al.*, CA No. 3-5231-C; and it appearing that the Court thereafter determined to sever the claims of the plaintiff-intervenor and the five individual named plaintiffs' and it appearing that on Thursday, June 28, 1979 the Court granted a directed verdict in favor of the defendants David A. Witts and Thomas J. Tierney; and it appearing that on Tuesday, July 3, 1979 the Court entered an order restyling this class action as set forth in the caption of this Final Judgment; and

It further appearing that on Tuesday, July 3, 1979 Special Issues directed to allegations made that one or more of remaining defendants had violated provisions of the Securities Exchange Act of 1934 ("the 1934 Act"), Rule 10b-5 promulgated thereunder, and the Texas Securities Act of 1957, as amended ("TSA"), by reason of alleged material omissions and other alleged fraudulent nondisclosures in the October 30, 1969 Registration Statement of TIS (hereinafter the "TIS Registration Statement") were submitted to the jury; and it appearing that on Friday, July 6, 1979 the jury rendered its Verdict on the Special Issues submitted; and

It further appearing that the Court having considered the Verdict, and various motions, supporting briefs, and other pleadings submitted by counsel on the issue of determining the measure of damages from purchases of TIS securities by the class representatives and the designated class during the period October 30, 1969 through January 28, 1970 (hereinafter "the class period") and various other matters, including a motion for judgment in favor of the five named individual plaintiffs notwithstanding the severance of their claims during the trial of the class action and a motion by the Trustee for Texas International Speedway, Inc. ("TIS") as plaintiff-intervenor to amend the pleadings to allege additional claims in this class action; and

It further appearing that after hearing oral argument of counsel on Monday, October 15, 1979 and Tuesday, October 16, 1979, the Court having rendered an opinion on the record in the course of which it found:

(a) defendants Lawrence A. Lopatin ("Lopatin"), Leslie Share ("Share") and Herman & MacLean, CPA's ("H&M") violated provisions of Section 10(b) of the 1934 Act, Rule 10b-5 promulgated thereunder, and Section 33 of the TSA by reason of material omissions and fraudulent non-disclosures in the TIS Registration Statement during the class period and thereafter by their failure to correct said omissions and non-disclosures or to give notice of the insolvency of TIS;

(b) the class representatives, the designated class and the five individual named plaintiffs (hereinafter sometimes collectively referred to as "the plaintiffs") are deemed as a matter of law to have purchased TIS securities in reliance upon the aforesaid unlawful failure to disclose, correct or give notice and any losses resulting from these purchases were therefore proximately caused by such unlawful conduct; and

(c) defendants Lopatin, Share and H&M are jointly and severally liable to the designated class representatives and members of the designated class for damages calculated on a rescissional basis equal to the net losses resulting from the purchase of TIS securities during the class period and to the five individual named plaintiffs for damages calculated on a rescissional basis equal to the net losses resulting from the purchase of TIS securities during the period January 29, 1970 through November 30, 1970; and

It further appearing that the Court having determined that there is no need to delay rendering a Final Judgment in this class action; and for other good cause appearing;

It is on this 16th day of October, 1979
ORDERED, ADJUDGED AND DECREED THAT:

1. Judgment for damages in the aggregate amount of $2,679,957, consisting of net losses from purchases of TIS securities during the class period plus prejudgment interest calculated at six percent (6%) per annum for the period January 29, 1970 through August 31, 1975 and nine percent (9%) per annum for the period September 1, 1975 through

if any advanced, is hereby assessed jointly and severally against defendants Lopatin, Share and H&M and awarded in favor of designated class representatives Huddleston and Bradley and those members of the designated class who submitted proofs of claims to the TIS Claims Committee on or before April 30, 1979, all as indentified by name, address and verified individual aggregate claims on summaries attached as one Exhibit "A" to this Final Judgment.

2. Judgment for damages in the aggregate amount of $47,932, consisting of net losses from purchases of TIS securities, plus prejudment interest calculated at six percent (6%) per annum for the period December 1, 1970 through Auugst 31, 1975 and nine percent (9%) per annum for the period September 1, 1975 through October 15, 1979, together with reimbursement of litigation expenses if any advanced, is hereby assessed jointly and severally against defendants Lopatin, Share and H&M and awarded in favor of the five individual named plaintiffs, Kemp, Plant, Waggoner, Barrett and Lostax, all as identified by name, address and verified individual aggregate claim on a summary attached as Exhibit "B" to this Final Judgment.

3. Judgment for damages in the aggregate amount of $270,509, consisting of net losses from purchases of TIS securities during the class period plus prejudgment interest calculated at six percent (6%) per annum for the period

January 29, 1970 through August 31, 1975 and nine percent (9%) per annum for the period September 1, 1975 through October 15, 1979 together with reimbursement of litigation expenses if any advanced, is hereby assessed jointly and severally against defendant Lopatin, Share and H&M and awarded in favor of those members of the designated class who submitted proofs of claims after April 30, 1979 but on or before October 1, 1979, all as identified by name, address and verified individual aggregate claim on summaries attached as one Exhibit "C" to this Final Judgment.

4. Judgment for reimbursement of costs in the aggregate amount of $54,722, consisting of an appropriate amount of litigation expenses incurred by the attorneys for the plaintiffs during the period May 15, 1972 through October 15, 1979 and administrative expenses of the TIS Claims Committee for the period July 6, 1978 through October 15, 1979, is hereby assessed jointly and severally against defendants Lopatin, Share and H&M and awarded in favor of the plaintiffs.

5. Based on payments made by certain settling defendants pursuant to partial settlements previously approved by the Court, it is hereby determined that defendants Lopatin, Share and H&M are entitled to a credit or offset in the amount of $401,313 consisting of principal payments made of $325,000 and interest at nine percent (9%) per annum on $275,000 for the period September 17, 1976 to October 15, 1979, against the amounts awarded as damages and reimbursement of costs to the plaintiffs in paragraphs 2, 3, 4 and 5 of this Final Judgment; accordingly, the net aggregate award of damages and costs to be assessed jointly and severally against defendants Lopatin, Share and H&M as a judgment collectively in favor of the plaintiffs is hereby determined to be $2,651,807 with interest on said net judgment to accrue at nine percent (9%) per annum commencing October 16, 1979 until paid.

6. The motion to amend of the Trustee for TIS as plaintiff-intervenor is hereby denied.

7. It is hereby determined that $700,000 is to be awarded Robert H. Jaffe, P.A., lead counsel for the plaintiffs, and $300,000 is to be awarded David S. Komiss, Esq., co-counsel for the plaintiffs for a total of $1,000,000 approved as reasonable compensation for legal services rendered by them in this class action during the period May 15, 1972 through October 15, 1979; from this amount counsel for plaintiffs are hereby authorized to pay Howard V. Tygrett Jr., Esq., the sum of $45,000 for legal services rendered in this class action in his capacity as attorney for plaintiff-intervenor which had the effect of benefiting the plaintiffs and for services performed as a member of the TIS Claims Committee.

(a) one half of said total approved attorney's fees or $500,000 is hereby assessed jointly and severally as an additional award of damages against defendants Lopatin, Share and H&M in favor of plaintiffs with interest on said judgment to accrue at nine percent (9%) per annum commencing October 16, 1979 until paid; and

(b) the remaining one half of the total approved attorney's fees less $60,000 previously paid from the proceeds of a partial settlement as authorized by order of this Court dated September 17, 1976, or $440,000, is hereby assessed against the net judgment for damages and costs plus interest awarded the plaintiffs as set forth in paragraph 6 of this Final Judgment, with interest on said net amount assessed to accrue at nine percent (9%) per annum until paid.

(c) Unless otherwise ordered by the Court, payment of attorney's fees approved to be paid to counsel for the plaintiffs is to be made on a proportionate basis

to the net aggregate judgment for damages and costs awarded plaintiffs out of the proceeds of any partial collection obtained from defendants Lopatin, Share and/or H&M.

8. It is hereby determined that defendants Lopatin, Share and H&M are barred as a matter of law from seeking indemnification or contribution from any defendant who has settled with the plaintiffs and who has been dismissed as a party defendant in the class action pursuant to certain Settlement Agreements previously approved by this Court.

9. Judgment on the jury's verdict is hereby rendered in favor of defendants Spencer J. Buchanan & Associates, Inc., George Kawamoto and Leo B. Margolian that plaintiffs and plaintiff-intervenor take nothing and that defendants Spencer J. Buchanan & Associates, Inc., George Kawamoto and Leo B. Margolian are dismissed on the merits, and that all costs of said defendants are taxed against the plaintiffs, for which let execution issue.

W. M. TAYLOR, JR.

W. M. TAYLOR, JR., *Senior Judge*
United States District Court

Securities Act of 1933

§ 4, 15 U.S.C. § 77d (1976)

§ 77d. Exempted transactions

The provisions of section 77e of this title shall not apply to —

(1) transactions by any person other than an issuer, underwriter, or dealer.

(2) transactions by an issuer not involving any public offering.

(3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except —

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

(B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 77h of this title is in effect as to the security), or such shorter period as the Commission may specify by rules and regulations or order, and

(C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

(4) brokers' transactions executed upon customers' orders on any exchange or in over-the-counter market but not the solicitation of such orders.

§ 5, 15 U.S.C. § 77e (1976)

§ 77e. Prohibitions relating to interstate commerce and the mails

(a) Sale or delivery after sale of unregistered securities

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) Necessity of prospectus meeting requirements of section 77j of this title.

It shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a

registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) Necessity of filing registration statement

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use of medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

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§ 11, 15 U.S.C. § 77k (1976)

§ 77k. Civil Liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue —

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof —

(1) that before effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration state-

ment purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made

by the official person or was not a fair copy of or extract from the public official document.

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for relief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) Effective date of registration statement with regard to underwriters

If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided,* That if the defendant proves that any portion

or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefits, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability

All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment,

unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) Offering price to public as maximum amount recoverable

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

§ 12, 15 U.S.C. § 77l (1976)

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

Any person who —

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of

any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

§ 13, 15 U.S.C. § 77m (1976)

§ 77m. Limitation of actions

No action shall be maintained to enforce any liability created under section 77k or 77*l*(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77*l*(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77*l*(1) of this title more than three years after the security was bona fide offered to the public, or under section 77*l*(2) of this title more than three years after the sale.

• • •

§ 17, 15 U.S.C. § 77q (1976)

§ 77q. Fraudulent interstate transactions

(a) Use of interstate commerce for purpose of fraud or deceit

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) Use of interstate commerce for purposes of offering for sale

It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) Exemption of section 77c not applicable to this section

The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

• • •

Securities Exchange Act of 1934

§ 10, 15 U.S.C. § 78j (1976)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commis-

sion may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

• • •

§ 18, 15 U.S.C. § 78r (1976)

§ 78r. Liability for misleading statements

(a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may use at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

(b) Contribution

Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

(c) Period of limitations

No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

• • •

§ 21(e), 15 U.S.C. § 78u (1976)

§ 78u(e). Investigations: Injunctions and prosecution of offenses

(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the proivsions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

§ 28(a), 15 U.S.C. § 78bb(a) (1976)

§ 78bb. Effect existing law

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provsions of this chapter shall recover, through satisfaction of judgment in one or more action, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

Joint Appendix

Office - Supreme Court, U.S.
FILED
JUN 16 1982
ALEXANDER L. STEVAS,

Nos. 81-680 and 81-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

HERMAN & MACLEAN,

Petitioner,

v.

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR., *et al.*,

Respondents.

and

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR., *et al.*,

Petitioners,

v.

HERMAN & MACLEAN, LAWRENCE A. LOPATIN, and LESLIE SHARE,

Respondents.

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

JOINT APPENDIX

PETITIONS FOR WRIT OF CERTIORARI
GRANTED APRIL 5, 1982

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IN THE

Supreme Court of the United States

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THE CASILLAS PRESS, INC. – 1717 K Street N.W. – Washington, D.C. – 223-1220

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LIST OF RELEVANT DOCKET ENTRIES IN THE UNITED STATES DISTRICT COURT

Date	PROCEEDING
1972	
Aug 25	Original Complaint filed.
Oct 25	Answer of Defendant Leslie Share, filed.
Nov 15	Answer and Cross-Claims of Defendant Ladenburg, Thalmann & Co., et al, filed.
Nov 15	Third-Party Complaint of Defendant Ladenburg, Thalmann & Co., et al filed.
Nov 17	Original Answer of Deft. Herman & MacLean, filed (with jury demand).
Nov 27	Answer and Cross-Claim of Defendant Rosenman Colin Kaye Petschek Freund & Emil, filed.
Dec 4	Answer of Deft. Spencer J. Buchanan & Associates, Inc. to Cross-Claim of Rosenman Colin Kaye Petschek Freund & Emil, filed.
Dec 4	Answer of Deft. Spencer J. Buchanan & Associates, Inc. to Cross-Claim of Defts. Ladenburg, Thalmann & Co., et al, and Answer of Third-Party Defendant Edsel J. Burkhart to Third Party Complaint of Ladenburg, Thalmann & Co., et al, filed.
Dec 5	Answer of Deft. Lawrence H. LoPatin and Amended Answer of Deft. Leslie Share, filed.
Dec 5	Reply of Defendants Lawrence H. LoPatin and Leslie Share to Cross-Claims, filed.

Dec 6 Original Answer of Third-Party Defendant, M. Richard Herman, to Third-Party Complaint of Defendant Joseph Sebag, Inc., filed.

Dec 6 Original Answer of Third-Party Deft. M. Richard Herman, to Third-Party Complaint of Deft. H. Hentz & Co., filed.

Dec 27 Answer of 3rd party Deft. Richard Herman.

Dec 29 Original Answer of Defendant, Herman & MacLean to Cross-Claims of Defendant, Manley, Bennett, McDonald & Co., filed.

1973

Jan 3 Order granting defendants' motion to transfer this cause to the Northern District of Texas, Dallas Division, entered (Order to be submitted).

Jan 8 Motion for Leave to Amend Answer of Third-Party Deft. M. Richard Herman: (No objection) First Amended Original Answer of Third-Party Deft. M. Richard Herman, to Third-Party Complaint of Deft. Joseph Sebag, Inc., filed.

Jan 16 Filed ORIGINAL ANSWER OF DEFENDANT, HERMAN & MACLEAN TO CROSS-CLAIM OF DEFENDANT, ROSEMAN COLIN KAYE PETSCHEK FREUND & EMIL.

Jan 16 Filed ORIGINAL ANSWER OF DEFENDANT, HERMAN & MACLEAN TO CROSS-CLAIM OF DEFENDANT, LADENBURG, THALMANN & CO. ET AL.

Jan 16 Filed ORIGINAL ANSWER OF DEFENDANT, HERMAN & MACLEAN TO CROSS-

CLAIMS OF DEFENDANT, JOSEPH SEBAG, INC.

Jan 16 Filed ORIGINAL ANSWER OF DEFENDANT, HERMAN & MACLEAN TO CROSS-CLAIMS OF DEFENDANT, H. HENTZ & CO.

Jan 16 Filed FIRST AMENDED ORIGINAL ANSWER OF DEFENDANT, HERMAN & MACLEAN TO CROSS-CLAIMS OF DEFENDANT, MANLEY, BENNETT, MCDONALD & CO.

Jan 22 Filed ORIGINAL ANSWER OF THIRD-PARTY DEFENDANT, M. RICHARD HERMAN, TO THIRD-PARTY COMPLAINT OF DEFENDANT MANLEY, BENNETT, MCDONALD & CO.

Jun 11 Filed PLAINTIFFS' MOTION FOR DETERMINATION OF SUIT AS CLASS ACTION.

Jun 11 Filed BRIEF IN SUPPORT OF MOTION FOR DETERMINATION OF SUIT AS CLASS ACTION.

Jun 18 Filed RESPONSE OF DEFENDANTS LADENBURG, THALMANN & CO., ET AL TO MOTION OF PLAINTIFFS FOR DETERMINATION OF SUIT AS A CLASS ACTION.

Jun 21 DEFTS (LADENBURG, THALMANN & CO., ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND AND EMIL) MOTION TO CONSOLIDATE AND RESPONSE TO PLAINTIFFS' MOTION FOR CLASS ACTION DETERMINATION.

Jul 11 Filed DEFTS (LAWRENCE H. LOPATIN AND LESLIE SHARE) MOTION TO CONSOLIDATE AND RESPONSE TO PLAINTIFFS' MOTION FOR CLASS ACTION DETERMINATION.

Nov 28 Filed ANSWER OF MR. RICHARD HERMAN TO THIRD-PARTY COMPLAINT OF JAMES TRIPPE.

Dec 10 Filed ANSWER OF RICHARD HERMAN TO THIRD PARTY COMPLAINT OF BOETTCHER & COMPANY, BUTCHER & SHERRERD, FIRST MID-AMERICA COMPANY, KOHLMEYER & COMPANY, MCKINNEY, ROSE & COMPANY, INC., RAUSCHER PIERCE SECURITIES CORPORATION, RUSS & COMPANY, INCORPORATED, SCHNEIDER, BERNET & HICKMAN, INC., AND UNDERWOOD, NEUHAUS & CO., INCORPORATED.

Dec 10 Filed ANSWER OF HERMAN & MACLEAN TO CROSS-CLAIM OF BOETTCHER & COMPANY, BUTCHER & SHERRERD, FIRST MID-AMERICA COMPANY, KOHLMEYER & CO., MCKINNEY, ROSE & COMPANY, INC., RAUSCHER PIERCE SECURITIES CORP., RUSS & COMPANY, INC., SCHNEIDER, BERNET & HICKMAN, INC., AND UNDERWOOD, NEUHAUS & CO., INCORPORATED.

Dec 10 Filed ORIGINAL ANSWER OF DAN HOLLOWAY AND HOLLOWAY SAND & GRAVEL.

Date	
1975	
Jan 8	Filed MOTION OF DEFENDANT FOR LEAVE TO FILE AN AMENDED ANSWER AND CROSS-CLAIMS.
Date	
1976	
Feb. 10	Filed DEFENDANTS' LADENBURG, THALMANN & CO., ET AL, MEMORANDUM IN OPPOSITION TO MOTIONS OF DEFENDANTS HERMAN & MACLEAN, EDSEL J. BURKHART, SPENCER J. BUCHANAN & ASSOCIATES, INC., DAN HOLLOWAY, AND HOLLOWAY SAND & GRAVEL COMPANY TO FILE AMENDED ANSWERS AND CROSS-CLAIMS.
Apr. 1	Filed DEFENDANT HERMAN & MACLEAN'S MEMORANDUM IN SUPPORT OF MOTION FOR LEAVE TO FILE AND AMENDED ANSWER AND CROSS CLAIM.
May 25	Filed ORDER GRANTING CLASS ACTION DETERMINATION WITH ATTACHED NOTICE OF PENDENCY OF CLASS ACTION.
May 25	Filed NOTICE OF PENDENCY OF CLASS ACTION AND SETTLEMENT HEARING.
May 25	Filed ORDER CORRECTING, MODIFYING AND SUPPLEMENTING CLASS ACTION

ORDER, TENTATIVELY APPROVING PARTIAL SETTLEMENT AND OTHER RELATED MATTERS.

Sep 17 Filed ORDER DIRECTING AND APPROVING DEPOSITORY FOR THE PARTIAL SETTLEMENT. . . UPON RECEIPT OF A CY OF THIS ORDER CERTIFIED TO BE A TRUE CY THE CLERK OF THE USDC FOR THE ND/TEXAS IS DIRECTED TO REMIT TO ROBERT H. JAFFE, P.A. AND/OR LIEBERMAN & KOMISS, ESQS., ANY SUMS DEPOSITED WITH THE CLERK BY ANY OF THE SETTLING DEFTS PLUS ANY INTEREST EARNED THEREON FOR DEPOSIT IN THE HOUSTON NATIONAL BANK PURSUANT TO THE TERMS OF THE SETTLEMENT AGREEMENT AND THE PROVISIONS OF THIS ORDER. . . SETTLING DEFTS ARE: LADENBURG, THALMANN & CO., JAMES TRIPPE, JOHN ROSENTHAL, HERBERT L. HOCHBERG, ROBERT O. MCDONALD, CARL K. ERPF, EDWARD J. ROSENTHAL, JOHN F. HEIMERDINGER, ROBERT LEIBOWITS, PETER DUNN, MARILYN E. LAMARCHE, MICHAEL BENNAHUM, DEVON SECURITIES, ZUCKERMAN, SMITH & CO., ROBERTS, SCOTT & CO., INC., COGAN, BERLIND, WEILL & LEVITZ, INC., JAMES C. BUTTERFIELD, INC., FREEHLING & CO., HERZFELD & STERN, MASON & LEE, INC., THE ROBINSON-HUMPHREY CO., INC., ROSENTHAL & CO., KENOWER, MACARTHUR & CO.,

FIRST OF MICHIGAN CORP., BLACK & CO., INC., D.H. BLAIR & CO., EMANUEL DEETJEN & CO., H. HENTZ & CO., JOSEPH SEBAG, INC., MANLEY, BENNETT, MCDONALD & CO., HERTZ, WARNER & CO., AND HANEY FISHNER; BOETTCHER AND CO., BUTCHER & SHERRERD, FIRST MID AMERICA CORP., KOHLMEYER & CO., MCKINNEY, ROSE & CO., INC., RAUSCHER PIERCE & CO., INC., RUSS & CO., INC., SCHNEIDER, BERNET & HICKMAN SECURITIES CORP., AND UNDERWOOD, NEUHAUS & CO., INC., ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL AND LADENBURG, THALMANN & CO., INC., KAMEN & CO., WEBER, HALL, COBB & CAUDLE, INC., SANDERS & CO., INC., AND EDWARDS & HANLEY SECURITIES, INC.

Sep 17 Filed ORDER AND JUDGMENT APPROVING PARTIAL SETTLEMENT, ETC.

Date

1979

Jun 13 Filed PLAINTIFFS' AND DEFTS' JURY ROLL AND JURY LISTS.

Jun 18 JURY TRIAL BEGAN.

Jun 26 Filed PLAINTIFFS' REQUESTED JURY INSTRUCTIONS AND ISSUES.

Jun 28 Filed PLAINTIFFS QUESTIONS FOR THE JURY.

Jun 28 Filed DEFT LEO B. MARGOLIAN'S MOTION FOR DIRECTED VERDICT.

Jun 28 Filed MOTION FOR DIRECTED VERDICT OF DEFTS TIERNEY & WITTS.

Jun 29 Filed JUDGMENT GRANTING MOTION FOR DIRECTED VERDICT OF DEFTS TIERNEY AND WITTS. CYS TO COUNSEL IN COURTROOM.

Jun 29 Filed PLAINTIFFS' REQUESTED JURY INSTRUCTIONS AND ISSUES.

Jul 3 Filed DEFTS HERMAN & MACLEAN AND M. RICHARD HERMAN MOTION FOR DIRECTED VERDICT.

Jul 3 Filed PLAINTIFFS' MOTION FOR DIRECTED VERDICT.

Jul 3 Filed DEFT HERMAN & MACLEAN'S EXCEPTIONS TO THE CHARGE OF COURT AND VERDICT.

Jul 3 Filed ORDER (BECAUSE OF SEVERANCE OF SOME DEFTS FROM THIS CAUSE) IT IS ORDERED THAT TITLE OF THIS CASE HEREAFTER READ AS FOLLOWS:

RALPH E. HUDDLESTON AND
CHESTER E. BRADLEY, JR.,
INDIVIDUALLY AND AS DESIGNATED
CLASS REPRESENTATIVES
VS
HERMAN & MacLEAN, CERTIFIED
PUBLIC ACCOUNTANTS,
a PARTNERSHIP, SPENCER J. BUCHANAN
& ASSOCIATES, INC., A CORP.,
LAWRENCE A. LOPATIN,

LESLIE SHARE,
GEORGE E. KAWAMOTO AND
LEO B. MARGOLIAN

Jul 3 Filed PLAINTIFFS' MOTION FOR DIRECTED VERDICT.

Jul 6 Filed CHARGE OF THE COURT AND VERDICT.

Jul 25 Filed MOTION TO DISREGARD JURY'S ANSWER TO SPECIAL ISSUES OF SPENCER J. BUCHANAN & ASSOCIATES, INC.

Jul 25 Filed BRIEF IN SUPPORT OF DEFENDANT SPENCER J. BUCHANAN & ASSOCIATES, INC.'S MOTION TO DISREGARD JURY'S ANSWER TO SPECIAL ISSUES.

Aug 15 Filed PLAINTIFF'S MEMORANDUM OF LAW IN SUPPORT OF ORDER ESTABLISHING DAMAGES, ENTITLEMENT TO PREJUDGMENT INTEREST AND ATTORNEYS' FEES PLUS COSTS OF SUIT.

Aug 15 Filed PLAINTIFFS' APPLICATION TO REIMBURSE PLAINTIFFS' COUNSEL FOR EXPENSES.

Aug 15 Filed AFFIDAVIT IN SUPPORT OF COSTS REIMBURSEMENT OF DAVID S. KOMISS.

Aug 15 Filed AFFIDAVIT OF ROBERT H. JAFFE, IN SUPPORT OF APPLICATION FOR REIMBURSEMENT OF EXPENSES.

Aug 16 Filed ORDER DENYING PLAINTIFFS LEAVE OF COURT TO FILE A SECOND AMENDED COMPLAINT AND GRANTING ADDITIONAL TIME FOR CLASS MEMBERS TO FILE PROOFS OF CLAIMS.

Sep 28 Filed MOTION OPPOSING PLAINTIFFS' PROPOSED ORDER AND JUDGMENT ON VERDICT AND DEFENDANT HERMAN & MACLEAN'S MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT.

Sep 28 Filed BRIEF IN SUPPORT OF MOTION OPPOSING PLAINTIFFS' PROPOSED ORDER AND JUDGMENT ON VERDICT AND DEFT. HERMAN & MaCLEAN'S MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT.

Sep 28 Filed MOTION FOR NEW TRIAL AND MEMORANDUM OF AUTHORITIES IN SUPPORT THEREOF.

Oct 1 Filed PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR ORDERS, DETERMINATIONS AND JUDGMENT BASED ON JURY VERDICT, ETC.

Oct 1 Filed DEFENDANTS LOPATIN AND SHARE'S MOTION FOR JUDGMENT N.O.V. OR IN THE ALTERNATIVE, FOR A NEW TRIAL.

Oct 1 Filed MEMORANDUM IN SUPPORT OF DEFENDANTS LOPATIN AND SHARE'S MOTION FOR A JUDGMENT N.O.V. OR, IN THE ALTERNATIVE, FOR A NEW TRIAL.

Oct 12 Filed AFFIDAVIT OF TRAVIS D. SULLIVAN, CPA IN SUPPORT OF REQUEST FOR DAMAGES TO BE AWARDED AS PART OF FINAL JUDGMENT.

Oct 12 Filed (ROBERT H. JAFFE'S) AFFIDAVIT OF COUNSEL IN SUPPORT OF REQUEST OF ITS CLAIMS COMMITTEE TO REIMBURSE AND EXPEND FUNDS.

Oct 15 Filed AN AFFIDAVIT OF JACK W. BARRETT.

Oct 15 Filed ORDER APPROVING SETTLEMENT AND DISMISSING CLAIMS WITH PREJUDICE IN SEVERED ACTION KEMP AND TYGRETT VS DAN HOLLOWAY AND HOLLOWAY SAND & GRAVEL CO., INC. . . $37,500 TO CLASS REPRESENTATIVES, THE INDIVIDUAL NAMED PLTFS, . . . AND $12,500 TO TRUSTEE AS PLTF-INTERVENOR IN THE CLASS ACTION AND AS PLTF IN THE RAIN ACTION, AND THAT INTEREST EARNED ON THE $50,000 PRINCIPAL HELD IN ESCROW WILL BE USED TO DEFRAY COSTS OF GIVING NOTICE OF SETTLEMENT AGREEMENT TO DESIGNATED CLASS AND OTHER RELATED EXPENSES. . . THIS ACTION HAVING PREVIOUSLY BEEN SEVERED FROM PRESENT HUDDLESTON SUIT, THIS ORDER CONSTITUTES A FINAL JUDGMENT IN THIS CAUSE.

O . . 16 Filed ORDER DENYING MOTIONS FOR JUDGMENT N.O.V., ETC.

Oct 16 Filed FINAL JUDGMENT.

Oct 31 Filed defts Herman & MacLean's NOTICE OF APPEAL from the final judgment entered on October 16, 1979.
Mailed copy of docket sheet, Notice & Certificate to 5th Circuit.

Nov 1 Filed defts Herman & MacLean's CERTIFICATE OF SERVICE TO NOTICE OF APPEAL that Notice was mailed to all counsel of record by James L. Truitt of Jackson, Walker, Winstead, Cantwell & Miller.

Nov 7 Filed defts Lopatin and Share's NOTICE OF APPEAL, from final judgment entered on October 16, 1979; copy of notice of appeal and docket sheet mailed to 5th Circuit.

Nov 7 Received Attys APPEAL INFORMATION SHEET.

Nov 8 Received Court Reporters Transcript Acknowledgment.

Nov 27 Filed certificated copy of ORDER from Court of Appeals stating: "BY THE COURT" Upon receipt of the application for emergency relief in this matter on Thursday, November 15, 1979, at 3:30 p.m., acting on behalf of a panel composed of 5th Circuit Court judges, ... Accordingly, no action will be taken until either further communication or briefs are received from counsel. They are to be filed before 5:00

p.m. November 28, 1979. (Judge Alvin B. Rubin) (copy to Judge Taylor).

Nov 28 Filed Appellant's HERMAN & MACLEAN'S MOTION FOR STAY OF EXECUTION OF JUDGMENT BASED UPON SUPERSEDEAS BOND.

Nov 28 Filed (Defts.) Appellant's MEMORANDUM OF AUTHORITIES IN SUPPORT OF MOTION FOR STAY OF EXECUTION OF JUDGMENT BASED UPON SUPERSEDEAS BOND.

Dec 13 Filed ORDER DENYING MOTION FOR STAY OF EXECUTION BASED ON SUPERSEDEAS BOND IN AN AMOUNT LESS THAN PROVIDED BY LOCAL RULE 12.4. and ORDERED that deft. H&M is hereby granted a temporary stay of execution until 1-15-80 in order to make arrangements to post a supersedeas bond in the amount of $3,782,418.40 or to seek further relief from the U. S. Court of Appeals for the 5th circuit, all without prejudice to plaintiffs' proceeding to obtain discovery in aid of execution on the final judgment entered in this class action.

Dec 17 Filed ORDER SUPERSEDING PRIOR ORDER DENYING MOTION FOR STAY, ETC.

(. . . that the order entered Dec. 13, 1979 is hereby vacated and superseded by this order; motion for stay of execution of judgment filed Nov. 28, 1979 by deft Herman & MacLean and heard by this court Dec. 13, 1979 is hereby denied; deft Herman & MacLean hereby

granted a temporary stay of execution of judgment until Jan. 15, 1980 without prejudice the pltfs' right to proceed to obtain discovery in aid of execution of judgment during such period.

Dec 18 Filed Herman & MacLean's DESIGNATION OF RECORD.

LIST OF RELEVANT DOCKET ENTRIES UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Date	
1/11/80	Flg. order GRANTING appellants' motion for stay pending appeal subject to appellants' filing supersedeas bond in the amount of $1,100,000.00.
3/19/81	Flg. Order granting motion of appellees for leave to file pet. for rehearing and pet. for rehearing en banc in excess of 15 pages but not to exceed 30 pages.
3/24/81	Flg. Order granting motion of appellees for leave to file pet. for rehearing and pet. for rehearing en banc in excess of 15 pages but not to exceed 30 pages.
4/9/81	Flg. Amicus Curiae Brief of Richard D. Latham, Securities Commissioner Texas, in support of appellees' petition for rehearing.
4/23/81	Flg. Order granting motion of SEC for leave to file amicus curiae brief in support of appellees' pet. for rehearing & rehearing en banc although Court notes for future information of the Commission that the time within which an application could be filed has expired.
4/30/81	Flg. Memorandum of SEC amicus curiae on petition for rehearing and rehearing en banc.
5/19/81	Flg. Letter of SEC amicus curiae with copy of opinion of Third Circuit in *Sharp v. Coopers & Lybrand* attached.

7/13/81 Flg. order DENYING petition for rehearing & suggestion for rehearing en banc; subparts B&C of Section V of opinion amended.

CLASS ACTION COMPLAINT GIVEN DOCKET NO. 72-H-1157 IN THE SOUTHERN DISTRICT OF TEXAS (Filed 8/25/72)

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

DAVID M. KEMP, THOMAS F.B. PLANT, FELTON F. WAGGONER, JACK H. BARRETT, DARYL R. LOSTAX, RALPH E. HUDDLESTON, CHESTER E. BRADLEY, JR., Plaintiffs. Individually, and on behalf of all other Security Purchasers of the Securities of Texas International Speedway, Inc.,

Plaintiffs,

-vs.-

LADENBURG, THALMANN & CO., a Partnership; LADENBURG & THALMANN CO., INC., a Corporation; HERMAN & MACLEAN, Certified Public Accountants, a Partnership; SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, a Partnership; GRAHAM, LOVING & CO., INC., a Corporation; JOHN ROSENTHAL; CARL K. ERPF; JOHN F. HEIMERDINGER; ROBERT M. LEIBOWITS; EDWARD J. ROSENTHAL; MICHAEL BENNAHUM; ROBERT O. McDONALD; JAMES TRIPPE; MARILYN E. LAMARCHE, PETER DUNN; HANEY FISHNER; HERBERT L. HOCHBERG; LAWRENCE H. LOPATIN; LESLIE SHARE; LEO B. MARGOLIAN; GEORGE E. KAWAMOTO; DAN HOLLOWAY; HOLLOWAY SAND & GRAVEL COMPANY, INC., a Corporation, Association of Selected Dealers being comprised of

the following broker-dealers; BLACK & COMPANY, INC.; D.H. BLAIR & COMPANY; BOETTCHER AND COMPANY: BUTCHER & SHERRERD; JAMES C. BUTTERFIELD, INC.; BUTTONWOOD CORPORATION; COGAN, BERLIND, WEILL & LEVITT, INC.; DEVON SECURITIES; EDWARDS & HANLEY SECURITIES, INC.; EMANUEL, DEETJEN & CO.; FIRST OF MICHIGAN CORPORATION; FIRST MID AMERICA CORPORATION; FREEHLING & CO.; H. HENTZ & CO.; HERTZ, WARNER & CO.; HERZFELD & STERN; HIRSCH & CO.; JEN SECURITIES, INC.; KAMEN & COMPANY; KENOWER, MacARTHUR & CO.; KOHLMEYER & CO.; MANLEY, BENNETT, McDONALD & CO.; MASON & LEE, INC.; McKINNEY, ROSE & COMPANY, INC.; PARKER, BISHOP & WELSCH, INC.; RAUSCHER PIERCE & CO., INC.; ROBERTS, SCOTT & CO., INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; RUSS & COMPANY, INC; SANDERS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; JOSEPH SEBAG INCORPORATED; UNDERWOOD, NEUHAUS & CO. INCORPORATED; WEBER, HALL, COBB & CAUDLE, INC.; ZUCKERMAN, SMITH & CO.; JOHN DOE; and RICHARD ROE, ET AL.,

Defendants.

Plaintiffs, by their attorneys Lieberman & Komiss, Esquires, and Reisdorf & Jaffe, P.A., complaining of the Defendants, allege on information and belief the following:

FIRST COUNT

1. This action is brought under Section 22 of the Securities Act of 1933, as amended, 15 U.S.C. par. 77v (The "1933 Act") and Section 27 of the Securities Exchange Act of 1934, as amended, 15 U.S.C. par. 78aa (The "1934 Act") and Section 1332 of the Judicial Code, 28 U.S.C. par. 1332, to enforce liabilities created by Section 17 of the 1933 Act, 15 U.S.C. par. 77q, Section 10(b) of the 1934 Act, 15 U.S.C. par. 78j, Rule 10b-5 of the Securities Exchange Commission ("SEC"), 17 C.F.R. par. 240.10b-5 and under principles of pendent jurisdiction. The amount in controversy exceeds, exclusive of interest and costs, the sum of $10,000.00.

2. Certain of the acts and transactions constituting the violations of the Federal Securities Laws alleged herein or constituting the offer or sale of securities described herein have occurred within the Southern District of Texas.

3. Plaintiffs bring this action under F.R.C.P. Rule 23 and other applicable Civil Rules of this Court on their own behalf and representatively on behalf of all persons who sustained a loss as the result of any purchase of the securities of Texas International Speedway, Inc., a Texas Corporation ("T.I.S."), from the time of such public offering, pursuant to a certain registration statement and prospectus dated October 30, 1969 and, by post-effective amendment, December 23, 1969 (hereinafter collectively referred to as the "T.I.S. Prospectus"), until bankruptcy proceedings were commenced against T.I.S., sometime late in 1970, or who otherwise were injured as a result of the unlawful practices, conduct, and activities described herein, or who were damaged as a consequence thereof, who may appear herein and prove their claims as provided in the Rules of this Court.

4. With respect to the class action, Plaintiffs will show to this Court:

a) The persons constituting this class are so numerous and scattered geographically so that a joinder of all would be impractical.

b) The following questions of law and fact are common to the class of Plaintiffs represented in this action: 1) The misrepresentations and material omissions of fact contained in the T.I.S. Prospectus, the Cover Page of which is attached as Exhibit "A" to this Complaint; 2) Reliance of members of the class thereon; 3) Damages sustained by members of the class; 4) Whether the aforesaid acts constitute violations of Section 17 of the 1933 Act, Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder.

c) The claims of the Plaintiffs, arising as they do from the misrepresentations and material omissions of fact relating to the aforesaid T.I.S. Prospectus and from the failure of Defendants to make disclosures to all members of the class between the T.I.S. Prospectus dates of October 30, 1969 and December 23, 1969 to and including the time bankruptcy proceedings were initiated against T.I.S., are typical of the claims of the class.

d) Plaintiffs have retained experienced counsel who are prepared to and intend to prosecute this action vigorously and to fairly and adequately protect the interest of the class. No other litigation concerning this controversy has been commenced by any member of the class.

e) Class relief is superior to other forms of relief herein. A multiplicity of suits in various jurisdictions by purchasers of the securities of

T.I.S. all over the U.S. with consequent burdens on the Courts and the tolling of the Statute of Limitations as to T.I.S. security purchasers who may not be aware of their rights will thereby be avoided. The amount of damages sustained by individual purchasers of T.I.S. securities may be so small as to discourage them from pressing their claims in the Courts. This class action will foster orderly and expeditious judicial administration of the class claims, economies of time, effort and expense will result, and uniformity of decision will be promoted. Most of the parties can be found or have done business in the Southern District of Texas and it is to the interest of all parties to concentrate the litigation of the claims of Plaintiffs in such District. This action presents no facets which would impede its management by this Court as a class action.

5. Unless some different basis of liability is specifically asserted with respect to any individual Defendant herein, liability is predicated upon the proposition that each of the Defendants acting alone or in consert with others initiated, joined in, became a member of or otherwise knowingly and/or negligently materially advanced, aided or abetted an unlawful fraud to commit, directly or indirectly, the wrongs and the illegal acts complained of herein. As such, each and all Defendants are liable, jointly and severally, for all losses incurred or damages sustained as a result of said unlawful acts and the wilful failure of Defendants to make disclosures of known material adverse information concerning T.I.S. to its security purchasers prior to October 30, 1969 and December 23, 1969, the dates set forth on the T.I.S. Prospectus.

6. Plaintiffs purchased securities of T.I.S. relying upon the information contained in the T.I.S. Prospectus. All of the Plaintiffs reside in the State of Texas.

7. At all times referred to herein, Defendant, Ladenburg, Thalmann & Co., ("Ladenburg"), was a partnership with its principal offices at 25 Broad Street, New York, N.Y. Ladenburg acted as the managing underwriter for the sale of the securities of T.I.S. pursuant to the T.I.S. Prospectus. Ladenburg on or about July 1, 1972 subsequently incorporated itself as Ladenburg, Thalmann & Co., Inc. a separate Defendant in this action. For the purposes of this Complaint, both the partnership and the corporation will be referred to as "Ladenburg".

8. At all times referred to herein, Defendant, Herman & MacLean, Certified Public Accountants, ("Herman"), was a partnership of Certified Public Accountants with its main offices in Detroit, Michigan and were listed in the T.I.S. Prospectus as experts in auditing and accounting.

9. At all times referred to herein, Defendant, Spencer J. Buchanan & Associates, Inc., ("Buchanan"), was a corporation with its principal offices in Bryan, Texas. Buchanan was listed in the T.I.S. Prospectus as expert in engineering, responsible for the information submitted in the T.I.S. Prospectus, particularly in the "use of proceeds" and "plant and property" sections.

10. At all times referred to herein, Defendant, Rosenman, Colin, Kaye, Petschek, Freund & Emil, Esquires, was a law partnership with offices in New York City which rendered expert legal counsel to Ladenburg and the other underwriters in connection with the public offering of T.I.S. securities by means of the T.I.S. Prospectus.

11. At all times referred to herein, Defendant, Graham, Loving & Co., Inc., with its principal offices located in the City of New York, was a broker dealer which participated in the public offering of the securities of T.I.S. and was indicated in the T.I.S. Prospectus as the recipient of a "Finders Fee" from Defendant, Ladenburg.

12. At all times referred to herein, Defendants, John Rosenthal, Carl K. Erpf, John F. Heimerdinger, Robert M. Leibowits, Edward J. Rosenthal, Michael Bennahum, Robert O. McDonald, James Trippe, Marilyn E. La Marche, Peter Dunn, Haney Fishner, and Herbert L. Hochberg, were General Partners of Defendant, Ladenburg, and thereby are jointly and severally liable for damages that were incurred by Plaintiffs and the class they represent as a consequence of the unlawful activities of Defendants. The Defendants named in this paragraph will be hereinafter referred to as Defendant "Ladenburg Partners" and their resident addresses are listed on a schedule attached to this Complaint to Exhibit "B."

13. At all times referred to herein, Defendants, Lawrence H. Lopatin, Leslie Share, Leo B. Margolian, and George E. Kawamoto, were officers and directors of T.I.S. with their resident addresses as set forth in the T.I.S. Prospectus.

14. At all times referred to herein, Defendant, Dan Holloway was President of Holloway Sand & Gravel Company, Inc., and named in the T.I.S. Prospectus as participating with Defendants, Lopatin and Share in various business ventures.

15. Defendant, Holloway Sand & Gravel Company, Inc., a corporation with its principal offices in Northville, Michigan, was the principal contractor for the construction of the speedway track which was the primary purpose of the use of proceeds from the sale of the T.I.S. securities made to Plaintiffs and the class they represent.

16. At all times hereinafter set forth, Defendants, Black & Company, Inc., D.H. Blair & Company, Boettcher and Company, Butcher & Sherrerd, James C. Butterfield, Inc., Buttonwood Corporation, Cogan, Berlind,

Weill & Levitt, Inc., Devon Securities, Edwards & Hanley Securities, Inc., Emanuel, Deetjen & Co., First of Michigan Corporation, First Mid America Corporation, Freehling & Co., H. Hentz & Co., Hertz, Warner & Co., Herzfeld & Stern, Hirsch & Co., JEN Securities, Inc., Kamen & Company, Kenower, MacArthur & Co., Kohlmeyer & Co., Manley, Bennett, McDonald & Co., Mason & Lee, Inc., McKinney, Rose & Company, Inc., Parker, Bishop & Welsch, Inc., Rauscher Pierce & Co., Inc., Roberts, Scott & Co., Inc., The Robinson-Humphrey Company, Inc., Rosenthal & Co., Russ & Company, Inc., Sanders & Company, Inc., Schneider, Bernet & Hickman Securities Corporation, Joseph Sebag Incorporated, Underwood, Neuhaus & Co. Incorporated, Weber, Hall, Cobb & Caudle, Inc., Zuckerman, Smith & Co., were broker dealers which agreed to participate in the public offering and sale of T.I.S. securities, pursuant to the T.I.S. Prospectus. A schedule of the principal offices of such Defendant Selected Dealers are set forth on Pages 25 through 27 of the T.I.S. Prospectus which has been attached as Exhibit "C" to this Complaint and constitute an Association of Selected Dealers.

17. The identities of the Defendants, John Doe and Richard Roe, Et Al., are presently unknown and/or Plaintiffs are presently without sufficient evidence to warrant naming such additional named Defendants at this time. Plaintiffs reserve the right to amend this Complaint if and when warranted by the obtaining of additional evidence which would justify the naming of such additional Defendants after the commencement of discovery proceedings pursuant to the applicable provisions of the Federal Rules of Civil Procedure.

18. On or about October 30, 1969, and subsequent thereto, Defendants used and employed manipulative and

deceptive devices and contrivances in connection with the purchase and sale of securities of T.I.S. in contravention of the 1933 Act, the 1934 Act, and Rule 10b-5. Such use and employment of manipulative and deceptive devices and contrivances involve the means and instrumentalities of interstate commerce and of the mails.

19. Such manipulative and deceptive devices and contrivances, schemes, false statements, illegal acts and practices included:

a) Employment of a device, scheme and artifice to defraud;

b) The making of untrue statements of material facts and omitting to state material facts necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading; and

c) The engagement of acts, practices, in a course of business which operated as a fraud and deceit upon Plaintiffs and the class of the purchasers of T.I.S. securities which they represent, all in connection with the sale or purchase of a security.

20. Among others, upon information and belief, the illegal acts and specific practices alleged above include the following:

(a) On October 30, 1969, T.I.S. offered for sale, through means of the T.I.S. prospectus, 3,000 units of its securities consisting of $1,000.00 principal amount of debentures and 100 shares of common stock at $3.33 per share and offered only in units of $1,333.00. Said T.I.S. Prospectus and its post-effective amendment dated December 23, 1969 contained various untrue

statements of material facts and admitted to state material facts necessary in order to make the statements made not misleading.

b) The aforesaid T.I.S. securities were offered to the public by Defendant, Ladenburg, through the use of the T.I.S. Prospectus. In such offer and sale, the mails and other instrumentalities of interstate commerce were employed by Defendant, Ladenburg, and the Defendant, Selected Dealers and Defendant, Graham, Loving & Co., Inc.

c) The Defendants who participated in the preparation of the T.I.S. Prospectus and/or had information which took on the nature of "insider information" which should have been disclosed to the public knew that the facts contained in said T.I.S. Prospectus were false and misleading. Such facts include but are not limited to the following:

(1) It was represented that the public offering would provide enough capital to complete the facility and provide the necessary promotional and administrative expenses to operate the type of auto races described in the T.I.S. Prospectus;

(2) It was represented that the capital raised by the issue would result in a balance of net proceeds available for general corporate purposes of $93,870;

(3) It failed to state that T.I.S. would not have sufficient operating capital to conduct its business and would have to commence operations with a negative operating fund;

(4) It was represented that 79% of the construction, preparation, promotional and administrative costs were based on firm contracts;

(5) It failed to state the existence of contingent liabilities in the form of open-ended construction contracts which could greatly increase the cost of the construction of the facility;

(6) It was represented that the construction estimates were accurate and valid at a time when the facility was at or near completion;

(7) It failed to state that as of its effective date the cost of the completion of the raceway facilities was approximately 20% greater than the construction estimates set forth in the "Use of Proceeds" section;

(8) It failed to state that the "Use of Proceeds section in the T.I.S. Prospectus was completely inaccurate and false; because the construction costs had been substantially underestimated and were therefore wrong;

(9) It was represented that T.I.S. had prepared itself for possible contingencies and that its parent company, American Raceway, Inc. would aid T.I.S. financially in the event of unforeseen financial difficulties;

(10) It failed to state the fact that the parent company of T.I.S., namely, American Raceways, Inc., a corporation of the State of Delaware, was in serious financial difficulty;

(11) It failed to state the fact that T.I.S. was in severe financial difficulty on October 30, 1969, the effective date of the T.I.S. Prospectus and that said financial difficulty had not been significantly relieved at the time of the post-effective amendment to the T.I.S. prospectus dated December 23, 1969.

21. Defendants knew and/or should have known that the purchasers of the securities of T.I.S. offered pursuant to the T.I.S. Prospectus would sustain losses and damages as a result of their reliance on the false and misleading statements and the omission of material facts necessary in order to make the statements made in the T.I.S. Prospectus not misleading.

22. Plaintiffs are aware that the large number of Defendants can cause judicial administrative problems and impede the expeditious disposition of this action: Therefore, as two particular classes of Defendants, namely, Defendants, Ladenburg Partners, and Defendants, Selected Dealers, have exactly the same defenses as all other members of their Defendant class, Plaintiffs hereby request that this Court issue an Order requiring each such class of Defendants to appoint a lead counsel which would represent all of their interest in this action.

WHEREFORE, Plaintiffs PRAY for judgment on the First Count of the Complaint as follows:

a) Enjoining Defendants, their agents, servants, and attorneys from further violation of the Federal Securities Laws;

b) Adjudging that the within action is a class action;

c) Ordering Defendants, Ladenburg Partners, and Defendants, Selected Dealers, to be

represented by one lead counsel for each such class of Defendants and thereby expedite the judicial administration of this action;

d) Awarding Plaintiffs and all members of the class they represent damages for the wrongs herein complained of together with interest;

e) Awarding Plaintiffs the expenses of this litigation including reasonable counsel fees and costs;

f) Granting Plaintiffs such other and further relief as may be equitable in the premises.

SECOND COUNT

1. Plaintiffs repeat and reallege each and every allegation contained in the First Count.

2. Defendant, Dan Holloway, and Defendant, Holloway Sand & Gravel Company, Inc. (hereinafter collectively referred to as "Holloway") had such a special "insider" relationship to T.I.S. that Defendants, Holloway, can be considered to have had a fiduciary relationship with respect to T.I.S. equal at least to Defendants, Lopatin and Share, officers and directors of T.I.S. with whom the said Defendants, Holloway, entered into other business dealings including the purchase of land adjacent to the property of T.I.S. and the construction of other speedways for companies controlled by said Defendants, Lopatin and Share.

3. On information and belief, Defendants, Holloway, in breach of their fiduciary duty, made excessive profits on the construction of the speedway track which was the primary use of the proceeds of the $4,398,900.00 received from Plaintiffs and the class they represent by virtue of the sale of T.I.S. securities, pursuant to the T.I.S. Prospectus.

4. Subsequently, knowing the financial difficulty which T.I.S. was experiencing sometime in late 1969 or the early part of 1970 Defendants, Holloway, used its special insider relationship with the officers and directors of T.I.S. to obtain the approval by the Board of Directors of T.I.S. of the imposition of liens in the approximate amount of $500,000.00 on all of the real property valued at excess of $5,500,000 owned by T.I.S. which was then subject only to a first lien of approximately $1,000,000.00.

5. Thereafter, Defendants, Holloway, foreclosed on all of the real property of T.I.S. and obtained title thereto.

6. Defendants, Holloway, thereby have used their special insider relationship with the officers and directors of T.I.S. in order to receive immense personal profit all to the detriment of Plaintiffs and the class they represent to whom said Defendants owed a fiduciary duty equivalent to that owed by his business partners, Defendants, Lopatin and Share.

7. Upon information and belief, Defendants, Holloway, in consert with other Defendant officers and directors of T.I.S., used their insider relationship to the detriment of the purchasers of T.I.S. securities in breach of their fiduciary duty. The extent of such abuse of their fiduciary duty can only be obtained and ascertained after discovery that will be instituted in this action under the applicable rules of this Court.

WHEREFORE, PLAINTIFFS PRAY for judgment on the Second Count of this Complaint as follows:

a) Awarding Plaintiffs and the class they represent damages for the wrongs herein complained of;

b) Awarding Plaintiffs the expenses of this

litigation including reasonable counsel fees and costs;

c) Granting Plaintiffs such other and further relief as may be equitable in the premises.

THIRD COUNT

1. Plaintiffs incorporate each and every allegation as contained in the First and Second Counts.

2. This Court has jurisdiction over the claims and allegations set forth in this Third Count because they are pendent to the federal claims alleged in the First and Second Counts as they derive from a common nucleus of operative facts.

3. The claims of Plaintiffs and the class they represent in this Third Count arise under the Securities Laws of the State of Texas, particularly Article 581-33 V.A.C.S., Vernon's Business and Commerce Code, Article 27.01 and the Common Law of the State of Texas.

4. On information and belief, both prior to the public offering of T.I.S. securities pursuant to the T.I.S. prospectus and during the period subsequent thereto, Defendants formulated a plan and entered into a course of conduct which was intended to and did fraudulently induce Plaintiffs and the class they represent to purchase the securities of T.I.S. at the initial public offering and in the after market sale of such T.I.S. securities. The fraudulent plan and course of conduct of Defendants consisted of knowingly and willfully making false and deceitful fraudulent statements in the T.I.S. Prospectus and the deliberate omission and failure to disclose adverse material facts necessary in order to make the statements made in the T.I.S. Prospectus not misleading. Defendants made such

false statements and omitted to disclose such material facts in order to personally benefit from the false misrepresentations and material omissions to the detriment of Plaintiffs and other T.I.S. security purchasers represented by them. The aforesaid acts by Defendants constitute fraudulent inducement of the sale of corporate securities in violation of the Statutes and Common Law of the State of Texas.

5. On information and belief, the Defendants used their insider position with T.I.S. to derive undisclosed personal benefits and profits in breach of their fiduciary duty they owed to T.I.S., Plaintiffs and the class represented by them. Such fraudulent acts are in violation of the Statutes and Common Law of the State of Texas.

WHEREFORE, PLAINTIFFS PRAY for judgment on the Third Count of the Complaint as follows:

a) The injunctive relief and accounting prayed for in the First and Second Counts of this Complaint;

b) Awarding Plaintiffs compensatory damages for the wrongs herein complained of;

c) Awarding Plaintiffs exemplary and punitive damages in an amount at least equal to double the compensatory damages for the wrongs herein complained of;

d) Awarding Plaintiffs the expenses of this litigation including reasonable counsel fees and costs; and

e) Granting Plaintiffs such other and further relief as may be equitable in the premises.

DATED this the 25th day of AUGUST, 1972.

LIEBERMAN & KOMISS, Esquires

By: _____

DAVID S. KOMISS
1515 Bank of the Southwest Bldg.
Houston, Texas 77002
Telephone: 224-2566(713)
ATTORNEYS FOR PLAINTIFFS

REISDORF & JAFFE, P.A.

By: _____

ROBERT H. JAFFE, Esquire
8 Mountain Avenue
Springfield, New Jersey 07081
Telephone: (201) 467-2246
CO-COUNSEL FOR PLAINTIFFS

EXHIBIT A

PROSPECTUS

3,300 Units

TEXAS INTERNATIONAL SPEEDWAY, INC.

(A Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

$3,300,000 8% Participating Subordinated Debentures due October 15, 1984

330,000 Shares of Common Stock ($1.00 par value)

Offered only in Units of $1,333 consisting of $1,000 principal amount of Debentures and 100 shares of Common Stock at $3.33 per share. The Debentures will bear interest payable quarterly from October 15, 1969 but no interest payment will be made thereon until April 15, 1970. (See captions "Introductory Statement" and "Description of Debentures" herein for certain terms of the Debentures.) The Debentures and Common Stock will be immediately separately transferable.

THESE SECURITIES INVOLVE A HIGH DEGREE OF RISK

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public (1)	Cash Underwriting Discounts, Commissions and Expenses (2)	Proceeds to the Company (3)
Per Unit	$1,333.00	$127.55	$1,205.45
Total	$4,398,900.00	$420,915.00	$3,977,985.00

(1) Plus accrued interest on the Debentures from October 15, 1969.

(2) Includes $395,915 ($119.97 per Unit) cash discount and $25,000 ($7.58 per Unit) cash for non-accountable expenses of the Underwriters. The Company has agreed to issue to Ladenburg, Thalmann & Co. (the "Representative"), in its individual capacity, a warrant to purchase 23,000 shares of Common Stock for five years at a price of $4.00 per share. The warrant is transferable only among the partners and employees of the Representative. In addition, Graham Loving & Co., a proposed Selected Dealer in this offering (see caption "Underwriting" herein), has purchased 10,000 shares of Common Stock at a price or $3.00 per share. These shares, and the shares issuable upon exercise or such warrant are included in the Registration Statement. Prior to any public offering of any such shares, the Company will file a Post-Effective Amendment indicating the terms of such offering. Any profits realized on the sale of such shares purchased by Graham Loving & Co. and any profits realized upon exercise of such warrant may be deemed additional underwriting compensation. The Representative will pay, out of its fee for managing this offering. $44,000 to Graham Loving & Co. as a finder's fee. The Company has also agreed to indemnify the Underwriters against certain liabilities under the Securities Act of 1933. (See caption "Underwriting" herein.)

(3) Before deduction of expenses of the Company in connection with this offering for such items as legal and accounting fees, printing expense and filing fees and for $11,000 paid in reimbursement of expenses and counsel fees to the aforementioned Graham Loving & Co. (See caption "Underwriting" herein.) The total expenses are estimated at $140,000 ($42.42 per Unit).

The offering price to the public has been arbitrarily determined by the Company without reference to book value or the Company's financial condition. The portion of the net proceeds of the securities offered hereby which the Company has allocated to the Common Stock will be approximately the same price per share as the Company received for the presently outstanding shares of Common Stock. See caption "Organizational Transactions" herein. The Company has not as yet commenced business. There is no market for these securities and no assurance can be given that a market will arise as a result of this offering. Attention is directed to the caption "Introductory Statement" herein for a discussion of certain risk features that affect these securities.

LADENBURG, THALMANN & CO.

The date of this Prospectus is October 30, 1969.

LITIGATION

On September 30, 1969 Dr. Hascall H. Muntz and Dr. T.W. Lyles instituted suit in the 7th District Court of Texas against the Company and Lawrence H. LoPatin upon their claim for compensation for alleged services in connection with the purchase of the Company's real estate. (See caption "Plant and Property" herein.) The suit alleges a contract between the plaintiffs and Lawrence H. LoPatin, individually and on behalf of the Company, for services, the performance of such services and the incurring of expense in connection therewith. No specification of the nature or amounts of such services and expenses is made therein. The suit further alleges breach of the contract by the defendants and seeks damages of $250,000 for

such breach and the additional sum of $250,000 from Lawrence H. LoPatin as exemplary damages for allegedly wrongfully inducing the Company to breach the contract. In the opinion of special counsel to the Company, Messrs. Scholl, Jenkins, Robinson & Stieg, any recovery by the plaintiffs would not exceed $56,000. The Company and Mr. LoPatin deny any liability and intend to defend the suit against the entire claim.

In October, 1969 the Company was advised by Texas International Raceway, Inc., a Texas corporation, that it deemed the name of the Company to be so similar to its name as to be deceptive and misleading and claimed priority in the use of its name. Texas International Raceway, Inc., which operates a one-quarter mile automobile race track in Houston, Texas, for the racing of midget, modified and super-modified cars, has demanded that the Company cease using the name Texas International Speedway, Inc. and has threatened to institute legal action to enforce its rights if the Company does not comply. Texas International Raceway, Inc. was incorporated on January 10, 1967 at which time Texas International Speedway, Inc., a Texas corporation incorporated June 15, 1966, was in existence. The Company subsequently, in March, 1969, acquired the charter of the latter corporation and on May 19, 1969 changed its name from Texas Motor Sports, Inc. to Texas International Speedway, Inc. In the opinion of Messrs. Witts, Lee, Pletcher and Douglass, counsel for the Company, the claim of Texas International Raceway, Inc. is without merit.

There is no other material litigation pending against the Company, and the Company knows of no other litigation which is threatened.

UNDERWRITING

The Underwriters named below have severally agreed, upon the terms and conditions contained in the Underwriting Agreement (a copy of which is filed as an exhibit to the Registration Statement), to purchase from the Company the number of Units set forth below opposite their respective names. Subject to certain conditions set forth in the Underwriting Agreement, the Underwriters are committed to purchase all of the Units offered hereby.

Name of Underwriter	Address of Underwriter	Number of Units to be Purchased
Ladenburg, Thalmann & Co.	25 Broad Street New York, N. Y. 10004	1,070
Black & Company, Inc.	300 American Bank Bldg. Portland, Oregon 97205	50
D.H. Blair & Company	66 Beaver Street New York, New York 10004	30
Boettcher and Company	828 17th Street Denver, Colorado 80202	50
Butcher & Sherrerd	1500 Walnut Street Philadelphia, Pennsylvania 19102	125
James C. Butterfield, Inc.	297 West Michigan Avenue Jackson, Michigan 49201	30
Buttonwood Corporation	4051 Penobscot Bldg. Detroit, Michigan 48226	30
Cogan, Berlind, Weill & Levitt, Inc.	767 Fifth Avenue New York, N.Y. 10022	125
Devon Securities	60 East 56th Street New York, N.Y. 10022	30
Edwards & Hanley Securities, Inc.	55 Broad Street New York, N.Y 10004	30
Emanuel, Deetjen & Co.	120 Broadway New York, N.Y. 10005	30

First of Michigan Corporation	Buhl Building Detroit, Michigan 48226	125
First Mid America Corporation.....	1001 "O" Street Lincoln, Nebraska 68501	30
Freehling & Co.	120 South LaSalle Street Chicago, Illinois 60603	50
H. Hentz & Co.	72 Wall Street New York, N.Y. 10005	125
Hertz, Warner & Co.	Two Broadway New York, New York 10004	30
Herzfeld & Stern	30 Broad Street New York, New York 10004	50
Hirsch & Co.	25 Broad Street New York, New York 10004	125
JEN Securities, Inc.	26635 Woodward Avenue Huntington Woods, MI 48070	30
Kamen & Company.....	50 Broadway New York, New York 10004	30
Kenower, MacArthur & Co.	Ford Building Detroit, Michigan 48226	30
Kohlmeyer & Co.....	147 Carondelet Street New Orleans, Louisiana 70130	125
Manley, Bennett, McDonald & Co. ..	1100 Buhl Building Detroit, Michigan 48226	30
Mason & Lee, Inc.....	Corner 8th & Church Streets Lynchburg, Virginia 24505	30
McKinney, Rose & Company, Inc.	Mercantile Bank Building Dallas, Texas 75201	50
Parker, Bishop & Welsh, Inc.	100 Park Avenue Oklahoma City, Oklahoma 73102	30
Ranscher Pierce & Co., Inc.....	1200 Mercantile Dallas Building Dallas, Texas 75201	125
Roberts, Scott & Co., Inc.	First National Bank Building San Diego, California 92101	50
The Robinson-Humphrey Co., Inc. ..	Two Peachtree Street, N.W. Atlanta, Georgia 30303	125
Rosenthal & Co.	40 Wall Street New York, New York 10005	50

Russ & Company, Inc.	Alamo National Bldg. San Antonio, Texas 78205	30
Sanders & Company, Inc.	830 Republic National Bank Bl. Dallas, Texas 75201	50
Schneider, Bernet & Hickman Securities Corporation	3200 First National Bank Building Dallas, Texas 75202	125
Joseph Sebag Incorporated	523 West Sixth Street Los Angeles, California 90014	30
Underwood, Neuhaus & Co. Inc.	724 Travis Houston, Texas 77002	125
Weber, Hall, Cobb & Caudle, Inc. ...	1800 LTV Tower Bldg. Dallas, Texas 75201	50
Zuckerman, Smith & Co.	30 Broad Street New York, N.Y. 10004	50
	Total	3,300

The Representative of the Underwriters has advised that sales to certain dealers may be made at concessions of $70 per Unit and that the Underwriters may allow, and such dealers may reallow, discounts of $25 per Unit on sales to certain other dealers. The public offering price and the concession and re-allowance may be changed after the initial public offering.

The Company has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

The Company has agreed to issue to Ladenburg, Thalmann & Co., the Representative of the Underwriters, in its individual capacity, a warrant exercisable between the first and fifth anniversary dates of the sale of the Units offered hereby to the Underwriters, to purchase 23,000 shares of Common Stock at $4.00 per share. The warrant is transferable only among the partners and employees of

Ladenburg, Thalmann & Co. The warrant contains provisions designed to protect against dilution through stock dividends, splits and distributions, recapitalizations, mergers, consolidations and similar transactions. The Company has agreed that, if requested by Ladenburg, Thalmann & Co., it will, at its expense, under certain conditions, file two Post-Effective Amendments to the Registration Statement of which this Prospectus forms a part covering all or any of the shares of Common Stock issuable upon the exercise of such warrant and that it will include all or any of such shares as part of any registration statement which the Company may file other than at the request of Ladenburg, Thalmann & Co.

The Company has also agreed to pay to the Representative of the Underwriters a non-accountable expense allowance of $25,000 for out-of-pocket expenses incurred in connection with this offering, including fees and expenses of counsel, other than in connection with the Indenture and other than Blue Sky expenses, both of which the Company will be required to pay.

EXHIBIT B

General Partners	Addresses	% of Ownership
John Rosenthal	RFD 1 Croton-on-Hudson, N.Y.	11 1/2
Carl K. Erpf	960 Park Avenue New York, N.Y.	10 3/4
John F. Heimerdinger	62 Windmill Road Armonk, N.Y.	10 3/4
Robert M. Leibowits	80 Central Park West New York, N.Y.	10 3/4
Edward J. Rosenthal	1165 Park Avenue New York, N.Y.	10 3/4
Michael Bennahum	65 Central Park West New York, N.Y.	10 3/4
Robert O. McDonald	7 Dell Drive Eastchester, N.Y.	10 3/4
James Trippe	R.R. #2, P.O. Box 178 Salem Road Pound Ridge, N.Y.	4
Marilyn E. LaMarche	114 Remsen Street Brooklyn, N.Y.	4
Peter Dunn	77-19 76th Street Glendale, Queens	2
Haney Fishner	160 Wolverine Street Staten Island, N.Y.	1
Herbert L. Hochberg	1 Tunstall Road Scarsdale, N.Y.	2

ANSWER OF DEFENDANT LESLIE SHARE ("SHARE") (Filed 10/25/72)

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

DAVID M. KEMP, et al.,
Plaintiffs,
-vs-
LADENBURG, THALMANN & CO., et al.,
Defendants.

Civil Action No. 72-H-1157

ANSWER OF DEFENDANT LESLIE SHARE

Leslie Share, one of the Defendants in the above entitled and numbered cause, for his preliminary answer to the complaint herein, answers, alleges and responds as follows:

I.

This is a class action against numerous Defendants, of whom sixty are named. The subject matter of the alleged cause of action is complex, and this Defendant presently does not have sufficient knowledge as to the allegations to file a definitive answer at this time. This Defendant will request leave to file an amended answer when he has had an opportunity to obtain more information as to the Plaintiffs' allegations.

II.

In answer to the specific allegation contained in paragraph 13 of Count I of the complaint, pertaining to him, this Defendant admits that on and before October 30, 1969, and for some time thereafter, he was a Director and Executive Vice President of T.I.S.

III.

This Defendant has insufficient information at this time to form a belief as to the truth of all other allegations contained in the complaint and therefore denies the same for the purpose of pleading. Defendant declares his intention and reserves the right to amend this preliminary answer as soon as he has sufficient information upon which to file a definitive response, including any Affirmative Defenses he may have, to all allegations contained in the complaint.

HONIGMAN MILLER SCHWARTZ
AND COHN

By: _____
David K. Page, Esq.
Attorneys for Defendant Leslie Share
2290 First National Building
Detroit, Michigan 48226
Phone: (313) 962-6700

Dated: October 20, 1972

CERTIFICATE OF SERVICE

I certify that on this 20th day of October, 1972, a copy of the foregoing Answer of Defendant Leslie Share was served upon the plaintiffs by mailing a copy to their attorneys of record, and upon the defendants by mailing a copy to their respective attorneys of record, and to defendants themselves if not represented by attorneys, by first class mail, postage prepaid.

_____

David K. Page

ANSWER OF DEFENDANT, HERMAN & MacLEAN

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

DAVID M. KEMP, et al., Plaintiffs,	)	
-vs.-	)	Civil Action
	)	No.
LADENBURG, THALMANN & CO., A Partnership, ET AL Defendants.	)	72-H-1157

TO THE HONORABLE JUDGE OF SAID COURT:

COMES NOW Herman & MacLean, sued herein as Herman & MacLean, Certified Public Accountants, a Partnership, and files this, its original answer to plaintiffs' original complaint on file herein, and for such answer would respectfully show unto the Court the following:

I.

This defendant says that the original complaint fails to state a cause of action upon which relief could be granted and, therefore, should be dismissed.

II.

With respect to the allegations of the complaint contained in the "FIRST COUNT" this defendant says:

(1) This defendant admits that plaintiffs claim they have a cause of action under the statutes referred to in paragraph 1 of the complaint. This defendant has no information regarding the plaintiffs' alleged damages, and, therefore, is

unable to admit or deny the plaintiffs' allegations regarding the amount in controversy.

(2) This defendant denies that it performed any acts or transactions that constituted violations of the Federal Securities Laws. This defendant admits that the plaintiffs claim that there were acts and transactions which took place in the Southern District of Texas.

(3) This defendant specifically denies that this action is properly maintainable as a class action by the plaintiffs as alleged in paragraph 3 of the complaint.

(4) This defendant specifically denies that this action is properly maintainable as a class action by the plaintiffs as alleged in paragraph of of the complaint. This defendant admits that "Exhibit A" attached to the plaintiffs' complaint purports to be a cover page of the T.I.S. prospectus. This defendant denies each and all of the other allegations contained in paragraph 4 of the complaint and each sub-paragraph (a) through (e) thereof.

(5) This defendant denies the allegations contained in paragraph 5 of the complaint.

(6) This defendant denies that plaintiffs purchased securities of T.I.S. relying upon the information contained in the T.I.S. prospectus as alleged in paragraph 6 of the complaint. This defendant has no information with regard to the identity of the plaintiffs and residence of the plaintiffs and, therefore, is unable to either admit or deny the allegations contained in paragraph 6 with regard to the plaintiffs' residency.

(7) This defendant has no information concern-

ing the residence, corporate or partnership structures, or activities of the other persons named as defendants in the complaint, and, therefore, this defendant is unable to either admit or deny the allegations contained in paragraph 7 and paragraphs 9 through 17 of the complaint.

(8) This defendant admits that the allegations contained in paragraph of the complaint are correct.

(9) This defendant denies each and all of the allegations contained in paragraph 18 and paragraph 19 and sub-paragraphs (a) through (c) of paragraph 19 of the complaint.

(10) This defendant would show that the T.I.S. prospectus speaks for itself, and, therefore, this defendant is not admitting or denying any allegations in paragraph 20 with regard to what is contained or not contained in the prospectus. This defendant has no information with regard to the sale of T.I.S. securities and, therefore, is unable to admit or deny the plaintiffs' allegations as to how the sale was handled. This defendant denies each and all of the remaining allegations of paragraph 20 of the complaint and sub-paragraphs (a) through (c) thereof. Specifically, this defendant denies that it was in any way involved in any illegal or improper acts.

(11) This defendant denies the allegations contained in paragraph 21 of the complaint.

(12) With regard to paragraph 22 of the complaint, this defendant denies that the plaintiffs have the right to maintain this action as a class action. This defendant is without sufficient information as to whether the two particular groups of defendants named in paragraph 22

have exactly the same defenses as other members of their alleged class, and, therefore, this defendant cannot say whether the Court should appoint a lead counsel for such groups of defendants should the Court determine that a class action is properly maintainable by the plaintiffs.

(13) This defendant denies that the plaintiffs are entitled to the relief prayed for in the prayer for judgment on the "FIRST COUNT" of the complaint.

III.

With respect to the allegations of the "SECOND COUNT" of the complaint, this defendant says:

(1) In response to paragraph 1, this defendant repeats the responses previously made to each and every allegation contained in the the first count, the same as if these responses had been repeated here.

(2) The allegations contained in paragraphs 2 through 7 pertain to other defendants. This defendant has no knowledge as to these allegations, and, therefore, is unable to admit or deny them.

(3) This defendant denies that plaintiffs are entitled to the relief prayed for in the prayer for judgment on the second count of the complaint.

IV.

With respect to the allegations of the "THIRD COUNT" of the complaint, this defendant says:

(1) In response to the allegation contained in paragraph 1 under the third count of the complaint, this defendant repeats the responses

which it has previously made to the allegations contained in the First and Second Counts of the complaint just as if these responses had been set out again.

(2) These defendants deny each and all of the allegations contained in paragraphs 2 through 5 of the Third Count of the complaint.

(3) This defendant denies that the plaintiff is entitled to the relief prayed for in the prayer for judgment on the third count of the complaint.

WHEREFORE, defendant, Herman & MacLean, sued herein as Herman & MacLean, certified public accountants, a partnership, prays that the plaintiffs take nothing against this defendant and that this defendant recover the costs and expenses which have been incurred because of the charges and allegations made against it in this lawsuit, and for such other and further relief to which this defendant is justly entitled.

Respectfuly submitted,

FULBRIGHT, CROOKER & JAWORSKI

By: _____
Frank G. Jones

By: _____
Kraft W. Eidman

OF COUNSEL:

FULBRIGHT, CROOKER & JAWORSKI
Bank of the Southwest Building
Houston, Texas 77002

CERTIFICATE OF SERVICE

This is to certify that on this the ____ day of November, 1972, a true and correct copy of the Original Answer of defendant, Hermann & MacLean was served upon plaintiffs' attorneys, Lieberman & Komiss by hand delivering same, and upon the other attorneys and parties hereafter listed, by placing same in the United States mail, postage prepaid.

_____

Frank G. Jones

REQUEST FOR JURY

Defendant, Herman & MacLean, hereby requests a jury trial in this matter.

_____

Frank G. Jones

ANSWER OF DEFENDANT LAWRENCE H. LOPATIN ("LOPATIN") AND AMENDED ANSWER OF SHARE (Filed 12/5/72)

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

DAVID M. KEMP, et al.,

Plaintiffs,

-vs.-

LADENBURG, THALMANN & CO., et al.,

Defendants.

ANSWER OF DEFENDANT LAWRENCE H. LoPATIN AND AMENDED ANSWER OF DEFENDANT LESLIE SHARE

Lawrence H. LoPatin ("LoPatin") and Leslie Share ("Share"), defendants in the above entitled and numbered cause, for their answer and amended answer respectively to the complaint herein, answer, allege and respond as follows:

1. Admit that this Court has jurisdiction of civil actions arising under Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v[a]) and Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa), as alleged in paragraph 1 of the first count of the complaint, but deny that said complaint states facts constituting a cause of action within such statutes or a claim upon which relief can be granted or facts constituting grounds to support the jurisdiction of the Court herein.

2. Deny each and every allegation contained in paragraph 2 of the first count of the complaint, except admit that a small amount of the securities offered and sold pursuant to a certain registration statement and prospectus covering the public offering by Texas International Speedway, Inc. ("T.I.S.") of 8% Participating Subordinated Debentures due October 15, 1984 and common stock, dated October 30, 1969, occurred within the Southern District of Texas.

3. Deny each and every allegation contained in paragraphs 3 and 4 of the first count of the complaint.

4. Deny each and every allegation contained in paragraph 5 of the first count of the complaint, except do not respond to the allegations contained in said paragraph insofar as they relate solely to defendants other than LoPatin and Share.

5. Deny knowledge or information sufficient to form a belief as to the allegations contained in paragraph 6 of the first count of the complaint.

6. Paragraphs 7, 8, 9, 10, 11 and 12 of the complaint make no allegations concerning LoPatin and Share and therefore no response is required or made thereto by LoPatin and Share.

7. Deny each and every allegation contained in paragraph 13 of the complaint pertaining to LoPatin and Share, except admit that on and before October 30, 1969, and for some time thereafter LoPatin and Share were officers and directors of T.I.S. with addresses as set forth in the T.I.S. prospectus.

8. Deny each and every allegation contained in paragraph 14 of the first count of the complaint, except admit that defendant Dan Holloway was, for at least a

portion of the times referred to in said complaint, President of Holloway Sand & Gravel Company, Inc., and respectfully refer to the aforesaid registration statement and prospectus for the contents thereof.

9. Deny each and every allegation contained in paragraph 15 of the first count of the complaint, except (a) admit that defendant Holloway Sand & Gravel Company, Inc., was the principal contractor for the construction of the T.I.S. speedway track facility, (b) deny knowledge or information sufficient to form a belief as to the location of said defendant's principal place of business, and (c) respectfully refer to the aforesaid registration statement and prospectus for the contents thereof.

10. Paragraph 16 of the first count of the complaint makes no allegations concerning LoPatin and Share and therefore no response is required or made thereto by LoPatin and Share.

11. Deny each and every allegation contained in paragraph 17 of the first count of the complaint.

12. Deny each and every allegation contained in paragraphs 18 and 19 of the complaint, except do not respond to the allegations contained in said paragraphs insofar as they relate solely to defendants other than LoPatin and Share.

13. Deny each and every allegation contained in paragraph 20(a) of the first count of the complaint, except admit that on October 30, 1969, T.I.S. offered for sale certain T.I.S. securities as identified in the aforesaid registration statement and prospectus.

14. Deny each and every allegation contained in paragraph 20(b) of the first count of the complaint, except admit that the aforesaid T.I.S. securities were offered to

the public by, among others, the defendant Ladenburg and the defendants named in paragraphs 11 and 16 of the first count of the complaint, and that, in connection therewith, the mails and other instrumentalities of interstate commerce were employed.

15. Deny each and every allegation contained in paragraphs 20(c) and 21 of the first count of the complaint except (a) refer to the aforesaid registration statement and prospectus for the contents thereof, and (b) deny knowledge or information sufficient to form a belief as to the allegations therein with respect to the knowledge or lack of knowledge of defendants other than LoPatin and Share concerning the matters set forth in said paragraphs 20(c) and 21.

16. Paragraph 22 of the complaint makes no allegations concerning LoPatin and Share and therefore no response is required or made thereto by LoPatin and Share.

17. Repeat and reallege each and every answer herein to each and every allegation contained in the first count of the complaint, as realleged in paragraph 1 of the second count of the complaint, as if set forth at length hereat.

18. Deny knowledge or information sufficient to form a belief as to each and every allegation contained in paragraph 2 of the second count of the complaint, except admit that defendants LoPatin, Share, and Holloway purchased certain land adjacent to property of T.I.S. and that defendant Holloway Sand & Gravel Company, Inc., was engaged in the construction of another speedway for a company in which LoPatin and Share were shareholders.

19. Deny knowledge or information sufficient to form a belief as to each and every allegation contained in paragraph 3 of the second count of the complaint.

20. Deny each and every allegation in paragraph 4 of the second count of the complaint, except admit that defendant Holloway Sand & Gravel Company, Inc. obtained liens on certain real property owned by T.I.S.

21. Deny knowledge or information sufficient to form a belief as to each and every allegation contained in paragraph 5 of the second count of the complaint, except admit that defendant Holloway Sand & Gravel Company, Inc. foreclosed its liens on certain real property theretofore owned by T.I.S. and obtained title thereto.

22. Deny each and every allegation in paragraphs 6 and 7 of the second count of the complaint except deny knowledge or information sufficient to form a belief as to the allegations contained in said paragraphs insofar as they relate solely to defendants other than LoPatin and Share.

23. Repeat and reallege each and every answer herein to each and every allegation contained in the first and second counts of the complaint, as realleged in paragraph 1 of the third count of the complaint, as if set forth at length hereat.

24. Deny each and every allegation contained in paragraphs 2 and 3 of the third count of the complaint.

25. Deny each and every allegation contained in paragraphs 4 and 5 of the third count of the complaint, except do not respond to the allegations contained in said paragraphs insofar as to relate solely to defendants other than LoPatin and Share.

FIRST DEFENSE

26. The complaint, and each and every cause of action contained therein, fails to state a claim upon which relief

can be granted to these plaintiffs against LoPatin and Share.

SECOND DEFENSE

27. Plaintiffs do not have standing to maintain this action in a representative capacity in behalf of the purported class described in the complaint.

THIRD DEFENSE

28. LoPatin and Share exercised reasonable care in attempting to determine that all of the factual statements contained in the aforesaid registration statement and prospectus were true and that the said documents did not omit to state any material facts, and said defendants did not know on the effective date of said registration statement and prospectus that either was misleading in any way.

FOURTH DEFENSE

29. The registration statement and prospectus represent that statements therein relating to construction costs and estimates were included therein in reliance on the opinion of defendant Spencer J. Buchanan & Associates, Inc. ("Engineers") of Bryan, Texas, an expert in the field of civil engineering retained by T.I.S. and responsible for the field supervision, quality control testing and civil engineering in the construction of the T.I.S. facilities.

30. Engineers duly executed and had filed with the Securities and Exchange Commission its consent to the use of its name as an expert and to the references in the registration statement and prospectus to its opinion concerning, among other things, construction costs and estimates.

31. LoPatin and Share had no reasonable ground to believe, and did not believe, at the time that said registration statement and prospectus became effective that the statements contained therein which were made in reliance on the opinion of Engineers were untrue or that there was any omission to state any material facts required to be stated therein or necessary to make said statements not misleading, or that said statements did not fairly represent the statement of the Engineers.

FIFTH DEFENSE

32. Plaintiffs' causes of action are barred by the applicable statutes of limitations.

SIXTH DEFENSE

33. The facts alleged in the complaint and claimed to constitute fraud, untrue statements and material omissions were discovered, or with the exercise of reasonable diligence should have been discovered, by plaintiffs and the class they purport to represent, more than one year preceding the commencement of this action.

SEVENTH DEFENSE

34. Plaintiffs' complaint is barred by the doctrine of exclusivity insofar as it is based upon purported violations of Section 17 of the Securities Act of 1933 and of the Securities Exchange Act since the alleged untrue statements and/or omissions of facts in the aforesaid registration statement and prospectus constitute exclusive violations, if any, of Sections 11 and 12 of the Securities Act of 1933.

WHEREFORE, defendants Lawrence H. LoPatin and Leslie Share demand judgment dismissing the complaint, together with the costs, attorneys' fees, and disbursements occasioned thereby.

HONIGMAN MILLER SCHWARTZ AND COHN

By: _____
David K. Page, Esq.

Attorneys for Defendants Lawrence H. LoPatin and Leslie Share
2290 First National Building
Detroit, Michigan 48226
962-6700

Dated: December 1, 1972

CERTIFICATE OF SERVICE

I certify that on this 1st day of December, 1972, a copy of the foregoing Answer of Defendant Lawrence H. LoPatin and Amended Answer of Defendant Leslie Share was served upon the plaintiffs by mailing a copy to their attorneys of record, and upon the defendants by mailing a copy to their respective attorneys of record, and to defendants themselves if not represented by attorneys, by first class mail, postage prepaid.

David K. Page

LETTER OPINION OF TRIAL COURT
CONCLUDING ACTION MAY BE MAINTAINED
AS CLASS ACTION (Dated 2/19/75)

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS 75202
February 19, 1975

W. M. TAYLOR, Jr.
Chief Judge

TO COUNSEL OF RECORD:

Re: David M. Kemp, et al, vs. Ladenburg, Thalmann & Co., et al, vs. Talbot Rain, as Trustee of Texas Internat'l Speedway, Inc., et al. CA 3-6677-C

Gentlemen:

I have concluded that the above case may be maintained as a class action. Plaintiffs' attorneys are requested to prepare and submit appropriate order, sending copies to all interested counsel.

Yours very truly,

/s/

W. M. Taylor, Jr.

LETTER OF TRIAL COURT TRANSMITTING PROPOSED ORDER GRANTING CLASS ACTION DETERMINATION AND ATTACHED NOTICE OF PENDENCY OF CLASS ACTION (Dated 8/25/75)

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS 75202
August 25, 1975

W. M. TAYLOR, Jr.
Chief Judge

TO COUNSEL OF RECORD:

Re: David M. Kemp, et al, vs. Ladenburg, Thalmann & Co., et al,CA 3-6677-C

Gentlemen:

Pursuant to my earlier decision, I plan to enter the attached Order Granting Class Action Determination. Also, I have decided that the attached Notice of Pendency of Class Action shall be used to notify potential class members of this lawsuit.

I recognize that this order is controlled by questions of law, as to which there may be a substantial ground for difference of opinion, and therefore the order contains the language necessary for either party to perfect an interlocutory appeal under 28 U.S.C. § 1292(b).

I invite your attention to paragraph 8 of the order which assigns the cost of notice to the plaintiffs. In my opinion *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156 (1974) requires

this. See also *Sirota v. Econo-Car International, Inc.*, 61 F.R.D. 604 (S.D.N.Y. 1974); *Madonick v. Denison Mines Limited*, 63 F.R.D. 657 (S.D.N.Y. 1974). I see no point in belaboring this issue with further briefs and argument.

In view of the short timetable allowed for a § 1292(b) appeal and possible business or vacation plans of the attorneys involved, I am writing this letter to inform you that the order will be entered during the week of September 8, 1975.

Yours very truly,

/s/

W. M. Taylor, Jr.

ORDER GRANTING CLASS ACTION DETERMINATION AND ATTACHED NOTICE OF PENDENCY OF CLASS ACTION (Filed 5/25/76)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, THOMAS F.B. PLANT, FELTON F. WAGGONER, JACK H. BARRETT, DARYL R. LOSTAX, RALPH E. HUDDLESTON, CHESTER E. BRADLEY, JR., Plaintiffs. Individually, and on behalf of all other Security Purchasers of the Securities of Texas International Speedway, Inc.,

Plaintiffs,

-vs.-

LADENBURG, THALMANN & CO., a Partnership; LADENBURG & THALMANN CO., INC., a Corporation; HERMAN & MACLEAN, Certified Public Accountants, a Partnership; SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, a Partnership; GRAHAM, LOVING & CO., INC., a Corporation; JOHN ROSENTHAL; CARL K. ERPF; JOHN F. HEIMERDINGER; ROBERT M. LEIBOWITS; EDWARD J. ROSENTHAL; MICHAEL BENNAHUM; ROBERT O. McDONALD; JAMES TRIPPE; MARILYN E. LAMARCHE; PETER DUNN; HANEY FISHNER; HERBERT L. HOCHBERG; LAWRENCE H. LOPATIN; LESLIE SHARE; LEO B. MARGOLIAN; GEORGE E. KAWAMOTO; DAN HOLLOWAY; HOLLOWAY SAND & GRAVEL COMPANY, INC., a Corporation, Association of Selected Dealers being comprised of the following broker-dealers; BLACK & COMPANY, INC.; D.H.

BLAIR & COMPANY; BOETTCHER AND COMPANY; BUTCHER & SHERRERD; JAMES C. BUTTERFIELD, INC.; BUTTONWOOD CORPORATION; COGAN, BERLIND, WEILL & LEVITT, INC.; DEVON SECURITIES; EDWARDS & HANLEY SECURITIES, INC.; EMANUEL, DEETJEN & CO.; FIRST OF MICHIGAN CORPORATION; FIRST MID AMERICA CORPORATION; FREEHLING & CO.; H. HENTZ & CO.; HERTZ, WARNER & CO.; HERZFELD & STERN; HIRSCH & CO.; JEN SECURITIES, INC.; KAMEN & COMPANY; KENOWER, MacARTHUR & CO.; KOHLMEYER & CO.; MANLEY, BENNETT, McDONALD & CO.; MASON & LEE, INC.; McKINNEY, ROSE & COMPANY, INC.; PARKER, BISHOP & WELSCH, INC.; RAUSCHER PIERCE & CO., INC.; ROBERTS, SCOTT & CO., INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; RUSS & COMPANY, INC; SANDERS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; JOSEPH SEBAG INCORPORATED; UNDERWOOD, NEUHAUS & CO. INCORPORATED; WEBER, HALL, COBB & CAUDLE, INC.; ZUCKERMAN, SMITH & CO.; JOHN DOE; and RICHARD ROE, ET AL.,

Defendants.

LADENBURG, THALMANN & CO.; JAMES TRIPPE; JOHN ROSENTHAL: HERBERT L. HOCHBERG; ROBERT O. McDONALD, CARL K. ERPF; EDWARD J. ROSENTHAL; JOHN F. HEIMERDINGER; ROBERT LIEBOWITS; PETER DUNN; DEVON SECURITIES; ZUCKERMAN, SMITH & CO.; ROBERTS, SCOTT & CO., INC.; COGAN, BERLIND, WEILL & LEVITT, INC.; JAMES

C. BUTTERFIELD, INC.; FREEHLING & CO.; HERZFELD & STERN; MASON & LEE, INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; KENOWER, MacARTHUR & CO.; FIRST OF MICHIGAN CORPORATION; BLACK & COMPANY, INC.; D. H. BLAIR & COMPANY; EMANUEL, DEETJEN & CO.; H. HENTZ & CO.; JOSEPH SEBAG INCORPORATED; MANLEY, BENNETT, McDONALD & CO.; HERTZ, WARNER & CO.; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL;

Third Party Plaintiffs,

vs.

TALBOT RAIN, as Trustee of Texas International Speedway, Inc.; EDSEL BURKHART, M. RICHARD HERMAN, THOMAS TIERNEY, DAVID WITTS, ROWLES-WINSTON & CO., INC., ED DRYDEN, JOHN S. TUSCHMAN, RICHARD RADY, JACK FALLAS, WILLIAM ACKLEY and PAT ROWLES,

Third Party Defendants.

ORDER GRANTING CLASS ACTION DETERMINATION

This matter having been first brought before this Court on or about June 6, 1973, by motion of the plaintiffs in the case entitled *David M. Kemp, et al., v. Ladenburg, Thalmann & Co., et al,* civil action No. Ca 3-6677-C, for an Order pursuant to Rule 23 of the Federal Rules of Civil Procedure to determine that the named plaintiffs represent

as a class all persons who purchased certain securities of Texas International Speedway, Inc. (the "Company"), and suffered damages as a result thereof, due to allegedly false and misleading statements of material facts and omissions of material facts in the amended registration statement and prospectus of the Company initially made effective and dated as of October 30, 1969; and the Court having held a pretrial conference on September 20, 1973, by notice of all counsel of record in CA 3-6677-C and in the related pending case entitled *Talbot Rain, as Trustee of Texas International Speedway, Inc., v. American Raceways, Inc., et al,* CA 3-5281-C; and the Court after hearing argument of counsel and consideration of the pleadings in the above entitled cases having entered an Order on November 12, 1973, consolidating the case in CA 3-6677-C with the case pending in CA 3-5281-C for purposes of pretrial discovery only with no requirement of repleading or realignment of the parties; and the Court having permitted discovery limited only to the question of class action determination until April 1, 1974; and the Court having considered the various briefs and affidavits filed in support of the class action determination in CA 3-6677-C filed by counsel for the plaintiffs, and having considered the briefs filed in opposition to said motion by Clark, West, Keller, Sanders & Ginsberg, Esqs., attorneys for defendant Ladenburg, Thalmann & Co. and various other defendants, and Rosenman, Colin, Kaye, Petschek, Freund & Emil, attorneys pro se and for Ladenburg, Thalmann & Co., Inc., and the opposing briefs filed by Carrington, Coleman, Sloman, Johnson & Blumenthal, Esqs., attorneys for defendant Boettcher and Company and various other defendants, and also having reviewed such additional opposing pleadings filed by counsel representing other named defendants; and the Court having heard extensive oral argument on the motion for class

action determination on July 2, 1974; and the Court having reviewed and considered the depositions, interrogatories, and other pleadings filed in the above consolidated cases;

Based on the foregoing, this Court hereby makes the following findings concerning the prerequisites to maintenance of a class action under subdivision (a) and (b)(3) of Rule 23 of the Federal Rules of Civil Procedure;

(a) That (1) the class of all persons, other than defendants, who purchased the Company's securities and suffered damages as a result thereof, in the original offering at the original offering price, on or about October 30, 1969, found by this Court to be a proper class is so numerous that joinder of all members is impractical, (2) there are questions of law and fact common to the class sought to be represented by the named plaintiffs, (3) the claims of the non-dismissed named plaintiffs as the representative parties are typical of the claims of the class they seek to represent, and (4) the named plaintiffs and their counsel do not appear to have any interest antagonistic to the class they seek to represent and will fairly and adequately represent the class;

(b) That the questions of law and fact common to the members of the class predominate over any questions affecting only individual members of the class;

(c) That after full consideration of the suggested pertinent criteria set forth in subdivision (b)(3) of Rule 23 of the Federal Rules of Civil Procedure, a class action appears to be superior to other available methods for the fair and efficient adjudication of the issues in the case in CA 3-6677-C; and for other good cause shown, it is accordingly

ORDERED, ADJUDGED and DECREED as follows:

1. The case entitled *David M. Kemp, et al. v. Ladenburg, Thalmann & Co., et al,* CA 3-6677-C, is hereby determined to be maintained as a class action under Rule 23(b)(3) of the Federal Rules of Civil Procedure.

2. The class to be represented by the named plaintiffs in the case in CA 3-6677-C shall include all persons, except the named defendants, therein who purchased securities of the Company and suffered damages as a result thereof during the period beginning October 30, 1969, and ending January 28, 1970.

3. The issues of fact and law that are common to the class as defined in paragraph 2 of this Order are (a) whether the registration statement and prospectus of the Company, filed with the United States Securities and Exchange Commission, made effective and dated as of October 30, 1969, contained false and misleading statements of material fact and omitted to state material facts necessary in order to make the statements of operating and financial condition in the aforesaid original registration statement and prospectus, in the light of the circumstances under which they were made, not misleading; (b) whether all or some of the named defendants are directly or indirectly responsible for the publication of the statements in the original prospectus; (c) whether all or some of the named defendants knew that the allegedly false and misleading statements and material omissions in the original registration statement and prospectus of the Company were false and misleading statements and contained material omissions or failed or refused to ascertain and disclose such misleading statements and material omissions when they were readily available and there was reasonable grounds to believe that such misleading

statements and material omissions existed; and (d) whether such actions or failure to take action in view of the alleged responsibility for and knowledge of these allegedly false and misleading statements and material omissions caused the named defendants to be in violation of federal securities laws and were the cause of damages to the class represented by the named plaintiffs as defined in paragraph 2 of the Order.

4. The issue of liability of the defendants for any alleged false and misleading statements and material omissions in the registration statement and prospectus, the issue of liability on cross claims, counterclaims and third-party complaints, and the issue of the amount of damages, if any, to which the named parties are entitled, shall be tried separately and first from any claims for damages raised in the complaint to persons other than the named parties.

5. The attorneys for defendants shall furnish counsel for plaintiffs within forty-five (45) days of this Order whatever information the defendants may have with respect to the indentity of the class, including the names and addresses of the persons for whom the Company's securities were purchased during the period beginning October 30, 1969, and ending January 28, 1970, and placed in "street name".

6. Within ninety (90) days of this Order the attorneys for the plaintiffs shall give notice to the class by mailing the attached form of Notice of Pendency of Class Action to each class member who can be identified through reasonable effort.

7. The plaintiffs shall bear the costs of notice to the class.

8. This Court does hereby retain jurisdiction under subdivision (c)(1) of Rule 23 of the Federal Rules of Civil Pro-

cedure to correct, modify, annul, vacate and supplement this Order as it may deem proper from time to time before any decision on the merits in the above consolidated cases.

9. The Court is of the opinion that this Order involves controlling questions of laws to which there is substantial grounds for difference of opinion and that an immediate appeal from the Order might materially advance the ultimate termination of this litigation.

10. All proceedings in this Court are stayed during the pendency of the interlocutory appeal pursuant to 28 U.S.C. Sec. 1292(b).

SIGNED and RENDERED at Dallas, Texas, this 25th day of May, 1975.

/s/M. W. Taylor, Jr.
M. W. Taylor, Jr.
United States District Judge

NOTICE OF PENDENCY OF CLASS ACTION AND SETTLEMENT HEARING
(Filed 5/25/76)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, THOMAS F.B. PLANT, FELTON F. WAGGONER, JACK H. BARRETT, DARYL R. LOSTAX, RALPH E. HUDDLESTON, CHESTER E. BRADLEY, JR., Plaintiffs, individually, and on behalf of all other Security Purchasers of the Securities of Texas International Speedway, Inc., Plaintiffs,

vs.

LADENBURG, THALMANN & CO., a Partnership; LADENBURG & THALMANN CO., INC., a Corporation; HERMAN & MACLEAN, Certified Public Accountants, a Partnership; SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, a Partnership; GRAHAM, LOVING & CO., INC., a Corporation; JOHN ROSENTHAL; CARL K. ERPF; JOHN F. HEIMERDINGER; ROBERT M. LEIBOWITS; EDWARD J. ROSENTHAL; MICHAEL BENNAHUM; ROBERT O. McDONALD; JAMES TRIPPE; MARILYN E. LAMARCHE; PETER DUNN; HANEY FISHNER; HERBERT L. HOCHBERG; LAWRENCE H. LOPATIN; LESLIE SHARE; LEO B. MARGOLIAN; GEORGE E. KAWAMOTO; DAN HOLLOWAY; HOLLOWAY SAND & GRAVEL COMPANY, INC., a Corporation; an Association of Selected Dealers being comprised of

the following broker-dealers; BLACK & COMPANY, INC.; D.H. BLAIR & COMPANY; BOETTCHER AND COMPANY; BUTCHER & SHERRERD; JAMES C. BUTTERFIELD, INC.; BUTTONWOOD CORPORATION; COGAN, BERLIND, WEILL & LEVITT, INC.; DEVON SECURITIES; EDWARDS & HANLEY SECURITIES, INC.; EMANUEL, DEETJEN & CO.; FIRST OF MICHIGAN CORPORATION; FIRST MID AMERICA CORPORATION; FREEHLING & CO.; H. HENTZ & CO.; HERTZ, WARNER & CO.; HERZFELD & STERN; HIRSCH & CO.; JEN SECURITIES, INC.; KAMEN & COMPANY; KENOWER, MacARTHUR & CO.; KOHLMEYER & CO.; MANLEY, BENNETT, McDONALD & CO.; MASON & LEE, INC.; McKINNEY, ROSE & COMPANY, INC.; PARKER, BISHOP & WELSCH, INC.; RAUSCHER PIERCE & CO., INC.; ROBERTS, SCOTT & CO., INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; RUSS & COMPANY, INC; SANDERS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; JOSEPH SEBAG INCORPORATED; UNDERWOOD, NEUHAUS & CO. INCORPORATED; WEBER, HALL, COBB & CAUDLE, INC.; ZUCKERMAN, SMITH & CO.; JOHN DOE; and RICHARD ROE, ET AL.,

Defendants,

LADENBURG, THALMANN & CO.; JAMES TRIPPE, JOHN ROSENTHAL, HERBERT L. HOCHBERG, ROBERT O. McDONALD, CARL K. ERPF, EDWARD J. ROSENTHAL, JOHN F. HEIMERDINGER, ROBERT LIEBOWITS, PETER DUNN, DEVON SECURITIES, ZUCKERMAN, SMITH & CO., ROBERTS, SCOTT & CO., INC., COGAN, BERLIND, WEILL & LEVITT, INC., JAMES C. BUTTERFIELD, INC., FREEHLING & CO., HERZFELD & STERN, MASON & LEE, INC., THE ROBINSON-HUMPHREY COMPANY, INC.,

ROSENTHAL & CO., KENOWER, MacARTHUR & CO., FIRST OF MICHIGAN CORPORATION, BLACK & COMPANY, INC., D. H. BLAIR & COMPANY, EMANUEL, DEETJEN & CO., H. HENTZ & CO., JOSEPH SEBAG INCORPORATED, MANLEY, BENNETT, McDONALD & CO., HERTZ, WARNER & CO., ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL,
Third Party
Plaintiffs,

vs.

TALBOT RAIN, as Trustee of Texas International Speedway, Inc., EDSEL BURKHART, M. RICHARD HERMAN, THOMAS TIERNEY, DAVID WITTS, ROWLES-WINSTON & CO., INC., ED DRYDEN, JOHN S. TUSCHMAN, RICHARD RADY, JACK FALLAS, WILLIAM ACKLEY and PAT ROWLES,
Third Party
Defendants.

NOTICE OF PENDENCY OF CLASS ACTION

This Notice is given pursuant to Rule 23 of the Federal Rules of Civil Procedure, and pursuant to an Order of the United States District Court for the Northern District of Texas ("the Court"), filed _____, 1975, to all persons, except the named defendants, who purchased securities of Texas International Speedway, Inc. (the "Company") and suffered damages as a result thereof during the period beginning October 30, 1969, and ending January 28, 1970. Such persons are collectively called the "Class".

You are *not* being sued. This Notice is being sent to you so that you may take steps to protect your rights. *By this Notice, the Court do not express any opinion regarding the merits of the above entitled action.* This Notice is intended solely to inform you about the nature of the action, its essential allegations, and the steps you might take concerning its possible effect on any claim you, as a potential member of the Class, may have against the named defendants.

The above entitled action asserts a claim by certain named plaintiffs, individually, and on behalf of the Class against named defendants who allegedly participated, directly or indirectly, in the preparation and filing of the registration statement and prospectus of the Company with the United States Securities and Exchange Commission and the Texas State Securities Board under the terms of which certain securities of the Company (consisting of "Units", common stock and debentures) were offered and sold to the public during the period beginning on or about October 30, 1969, and ending January 28, 1970, which date marked the end of the ninety-day period during which the prospectus was required to be kept effective.

This class action has been brought under the provisions of the Securities Act of 1933, as amended, the Securities and Exchange Act of 1934, as amended, and the Texas Securities Act of 1957, as amended. The complaint in this class action alleges in substance that all or some of the named defendants are directly or indirectly responsible for or knew or should have had knowledge of certain alleged false and misleading statements and material omissions in the registration statement and prospectus of the Company initially made effective and dated as of October 30, 1969, and subsequently amended on November 12, 1969, and December 23, 1969, and that the Class suffered damages

by purchasing securities of the Company in reliance upon information obtained from such alleged misleading amended registration statement and prospectus. The complaint in this Class Action also alleges that certain of the defendants had violated fiduciary duties owed to the Class and used their insider relationship with the Company to the detriment of the Class.

The named defendants include the managing underwriter, its partners and an alleged successor corporation, all of the selected broker dealers who participated in the firm underwriting of the securities of the Company at the time of the initial public offering on or about October 30, 1969, the attorneys for the underwriters, the officers and directors of the Company, the certified public accountants for the Company, the general contractor who received the bulk of the proceeds of the sale of securities of the Company and subsequently foreclosed on the real property of the Company, the engineering consulting firm for the Company and certain other individuals and corporations affiliated with the other named defendants. The defendants have denied all the allegations of the complaint. In addition, certain of the defendants have cross-claimed against other defendants and third-party complaints have been filed against persons not named as defendants in the original complaint. For purposes of pretrial discovery only, this action has been consolidated with the related pending case entitled *Talbot Rain, as Trustee of Texas International Speedway, Inc., v. American Raceways, Inc., et al.*, CA 3-5281-C.

The Court has ruled that this action shall proceed, pursuant to the provisions of Rule 23 of the Federal Rules of Civil Procedure, as a class action on behalf of the Class as above described. Such ruling is procedural in nature and, as previously stated, the Court expresses no opinion regar-

ding the merits of the claims made by the named plaintiffs in this action. The named plaintiffs, by their attorneys, will represent the Class in all subsequent proceedings in this class action. If you are a potential member of the Class, you do not have to appear personally or by your attorney to be considered a party to this class action.

Pursuant to Rule 23 (c)(2) of the Federal Rules of Civil Procedure, you are hereby given notice that you have the following rights:

1. *The Right to be Excluded:* If you are a potential member of the Class as described in the first paragraph of this Notice, you have the right to request that the Court exclude you from this class action. Persons who request exclusion will not be entitled to share in the benefits of any jugdment if it is favorable to the named plaintiffs and the Class, and will not be bound by any judgment if it is adverse to the named plaintiffs and the Class. To be excluded, you *must* notify the Clerk of the Court on or before the day of_____. You may do this by simply sending a post card or letter to The Honorable Joseph McElroy, Jr., Clerk of the Court of the United States District Court for the Northern District of Texas, Federal Building, 1100 Commerce Street, Dallas, Texas 75202. You should state that "I, (*your name*), elect to be excluded from the Class in the case of *David M. Kemp, et al., v. Ladenburg, Thalmann & Co., et al,* CA 3-6677-C." Please sign and date the post card or letter.

2. *The Right to Appear by Counsel:* If you are a potential member of the Class and do not wish to elect to be excluded, you may, if you desire, enter an appearance in this action through counsel of your own choosing. If you do not request exclusion and do not enter an appearance

through your own counsel, your interest will be represented by the named plaintiffs, by their counsel, as attorneys for the Class.

You are hereby given notice of the effect of a judgment in this class action: If you are a potential member of the Class and do not request exclusion you will be included in the Class and be bound by a judgment in this class action whether it be favorable or unfavorable. You will also be bound by any settlement in this class action approved by this Court. Regardless of the outcome of this action, you will *not* have to pay any counsel fees for the attorneys for the named plaintiffs as class representatives. If the named plaintiffs are successful, the attorneys for the named plaintiffs will be paid out of any recovery obtained for the Class.

If you require further information or have any questions concerning this Notice or the action described herein, you may contact The Honorable Joseph McElroy, Jr., Clerk of the United States District Court for the Northern District of Texas.

Do not call or write to Judge W. M. Taylor, Jr.

/s/ W. M. Taylor, Jr.
United States District Judge

ORDER CORRECTING, MODIFYING AND SUPPLEMENTING CLASS ACTION ORDER, TENTATIVELY APPROVING PARTIAL SETTLEMENT AND OTHER RELATED MATTERS
(Filed 5/25/76)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, THOMAS F.B. PLANT, FELTON F. WAGGONER, JACK H. BARRETT, DARYL R. LOSTAX, RALPH E. HUDDLESTON, CHESTER E. BRADLEY, JR., Plaintiffs, individually, and on behalf of all other Security Purchasers of the Securities of Texas International Speedway, Inc., Plaintiffs, and

HOWARD V. TYGRETT, JR., as Trustee of Texas International Speedway, Inc., Plaintiff-Intervenor,

vs.

LADENBURG, THALMANN & CO., a Partnership; LADENBURG & THALMANN CO., INC., a Corporation; HERMAN & MACLEAN, Certified Public Accountants, a Partnership; SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, a Partnership; GRAHAM, LOVING & CO., INC., a Corporation; JOHN ROSENTHAL; CARL K. ERPF; JOHN F. HEIMERDINGER; ROBERT M. LEIBOWITS; EDWARD J. ROSENTHAL; MICHAEL BENNAHUM;

ROBERT O. McDONALD; JAMES TRIPPE; MARILYN E. LAMARCHE; PETER DUNN; HANEY FISHNER; HERBERT L. HOCHBERG; LAWRENCE H. LOPATIN; LESLIE SHARE; LEO B. MARGOLIAN; GEORGE E. KAWAMOTO; DAN HOLLOWAY; HOLLOWAY SAND & GRAVEL COMPANY, INC., a Corporation; DAVID WITTS; THOMAS TIERNEY; an Association of Selected Dealers being comprised of the following broker-dealers: BLACK & COMPANY, INC.; D.H. BLAIR & COMPANY; BOETTCHER AND COMPANY; BUTCHER & SHERRERD; JAMES C. BUTTERFIELD, INC.; BUTTONWOOD CORPORATION; COGAN, BERLIND, WEILL & LEVITT, INC.; DEVON SECURITIES; EDWARDS & HANLEY SECURITIES, INC.; EMANUEL, DEETJEN & CO.: FIRST OF MICHIGAN CORPORATION; FIRST MID AMERICA CORPORATION; FREEHLING & CO.; H. HENTZ & CO.; HERTZ, WARNER & CO.; HERZFELD & STERN; HIRSCH & CO.; JEN SECURITIES, INC.; KAMEN & COMPANY; KENOWER, MacARTHUR & CO.; KOHLMEYER & CO.: MANLEY, BENNETT, McDONALD & CO.; MASON & LEE, INC.; McKINNEY, ROSE & COMPANY INC.; PARKER, BISHOP & WELSCH, INC.; RAUSCHER PIERCE & CO., INC.; ROBERTS, SCOTT & CO., INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; RUSS & COMPANY, INC; SANDERS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; JOSEPH SEBAG INCORPORATED; UNDERWOOD, NEUHAUS & CO. INCORPORATED; WEBER, HALL, COBB & CAUDLE, INC.; ZUCKERMAN, SMITH & CO.; JOHN DOE; and RICHARD ROE, ET AL.,

Defendants

LADENBURG, THALMANN & CO.; JAMES TRIPPE; JOHN ROSENTHAL; HERBERT L. HOCHBERG; ROBERT O. McDONALD;

CARL K. ERPF; EDWARD J. ROSENTHAL; JOHN F. HEIMERDINGER; ROBERT LIEBOWITS; PETER DUNN; DEVON SECURITIES; ZUCKERMAN, SMITH & CO.; ROBERTS, SCOTT & CO., INC.; COGAN, BERLIND, WEILL & LEVITT, INC.; JAMES C. BUTTERFIELD, INC.; FREEHLING & CO.; HERZFELD & STERN; MASON & LEE, INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; KENOWER, MacARTHUR & CO.; FIRST OF MICHIGAN CORPORATION; BLACK & COMPANY, INC.; D. H. BLAIR & COMPANY; EMANUEL, DEETJEN & CO.; H. HENTZ & CO.; JOSEPH SEBAG INCORPORATED; MANLEY, BENNETT, McDONALD & CO.; HERTZ, WARNER & CO.; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, BOETTCHER AND COMPANY; BUTCHER & SHERRERD; FIRST OF MID AMERICA CORPORATION; KOHLMEYER & CO.; McKINNEY, ROSE & COMPANY INC.; RAUSCHER PIERCE & CO., INC.; RUSS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; AND UNDERWOOD, NEUHAUS & CO. INCORPORATED

Third Party Plaintiffs,

vs.

TALBOT RAIN, as Trustee of Texas International Speedway, Inc.; EDSEL BURKHART; M. RICHARD HERMAN; THOMAS TIERNEY; DAVID WITTS; ROWLES-WINSTON & CO., INC.; ED DRYDEN; JOHN S. TUSCHMAN; RICHARD RADY; JACK FALLAS; WILLIAM ACKLEY and PAT ROWLES;

Third Party Defendants.

This matter having been brought before this Court by motion of the plaintiffs who seek to represent certain purchasers of the securities of Texas International Speedway, Inc., (referred to hereinafter as the "Company" or "TIS")

in the case entitled *David M. Kemp, et al., vs. Ladenburg, Thalman & Co., et al.,* index number CA 3-6677-C ("the class action") for (a) modification of the Court's proposed Order Granting Class Action Determination distributed to counsel of record under cover of the Court's letter dated August 25, 1975 so as to provide that (i) the issue of liability on crossclaims, counterclaims and third party claims asserted by any party after August 25, 1975 be bifurcated and tried separately from the claims of the plaintiffs and the plaintiff-intervenor in the class action and (ii) the proceedings in the class action be continued notwithstanding any interlocutory appeal of a modified Order Granting Class Action Determination, (b) tentative approval of a partial settlement in the class action and the consolidated case entitled *Talbot Rain, as Trustee of Texas International Speedway, Inc. vs. American Raceways, Inc., et al.,* index number CA 3-5281-C ("the Trustee action") pursuant to the terms of a proposed Settlement Agreement to be entered into among representatives of the plaintiffs, the plaintiff-intervenor and certain of the defendants in the above consolidated cases, and (c) modification of the Court's proposed Notice of Pendency of Class Action made part of the proposed Order Granting Class Action Determination to incorporate notice of the partial settlement and to provide for a hearing date for the purpose of, *inter alia,* determining whether the Court should enter judgment in accordance with the terms of the aforesaid Settlement Agreement; and the Court having held a pretrial conference on December 11, 1975 with notice to all counsel of record in the class action and the Trustee action, and the Court after hearing argument of counsel having ruled that leave to file any amended answers and/or assert a crossclaim and/or third party claim and all pleadings, memorandums, and motions in support and opposition to same be filed and distributed to counsel of

record pursuant to a schedule set forth in a letter of the Court dated December 11, 1975; and the Court having held a subsequent pre-trial conference on April 19, 1976 with notice to all counsel of record and after hearing further argument of counsel, having considered the terms of the proposed Settlement Agreement, all proposed amended answers, counterclaims, crossclaims and third party complaints filed since August 25, 1975 and pleadings, memorandum and motions supporting and opposing same; and after consideration of all previous pleadings and memorandum filed in the above consolidated cases; and for other good cause shown, it is accordingly:

ORDERED, ADJUDGED and DECREED as follows:

1. The Order Granting Class Action Determination ("Class Action Order") in the class action distributed to all counsel of record on August 25, 1975 will be filed simultaneously with this Order and is deemed to be corrected, modified and supplemented pursuant to Paragraph 8 thereof as follows:

(a) Paragraph (a)(3) of the findings of the Court concerning the prerequisites to maintenance of a class action set forth in the prefatory portion of the Class Action Order is corrected to read as follows: "The claims of certain of the named plaintiffs, specifically plaintiffs Ralph E. Huddleston and Chester E. Bradley, Jr., as the representative parties are typical of the claims of the class they seek to represent."

(b) Paragraph 2 of the Class Action Order will be modified to read as follows: "The class to be represented by certain of the named plaintiffs, specifically plaintiffs Ralph E. Huddleston and Chester E. Bradley, Jr., in the case in CA 3-6677-C shall include all persons, except the named defendants, therein who purchased securities of the

Company and suffered damages as a result thereof during the period beginning October 30, 1969, and ending January 28, 1970.";

(c) Paragraph 4 of the Class Action Order will be modified to read as follows: "The issue of liability of the defendants for any alleged false and misleading statements and material omissions in the registration statement and prospectus of the Company and the issue of damages, if any, to which the named plaintiffs and the plaintiff-intervenor are entitled, shall be tried separately and first from the issue of liability on crossclaims, counterclaims and third party claims asserted after August 25, 1975 and any claims for damages alleged in the class action complaint to persons other than the named plaintiffs and the plaintiff-intervenor and on crossclaims, counterclaims and third party complaints asserted after August 25, 1975";

(d) Paragraph 5 of the Class Action Order will be modified to read as follows: "The attorneys for defendants shall furnish counsel for plaintiffs within forty-five (45) days of this Order whatever information the defendants may have with respect to the identity of the class, including the names and last known addresses of the persons for whom the Company's securities were purchased during the period beginning October 30, 1969, and ending January 28, 1970, and placed in 'street name'.";

(e) Paragraph 6 of the Class Action Order will be corrected and superseded by paragraph 3 of this Order;

(f) Paragraph 9 of the Class Action Order will be modified and supplemented to read as follows: "The Court is of the opinion that this Order involves controlling questions of law as to which there is substantial grounds for difference of opinion and that an immediate appeal from this Order, but not any subsequent amendment or

modification hereof unless expressly so provided, might materially advance the ultimate termination of this litigation;" and

(g) Paragraph 10 of the Class Action Order is deleted in its entirety.

2. This Court hereby tentatively approves the terms of Settlement Agreement to be entered into among representatives of the named plaintiffs, the plaintiff-intervenor and certain of the defendants herein and determines that the Notice of Pendency of Class Action to be sent to the class of persons who purchased securities of TIS as described in the Class Action Order as corrected, modified, and superseded by Paragraph 1 of this Order shall incorporate notice of the partial settlement of the class action, shall provide for September __, 1976 as the date of hearing for the purpose of determining whether the terms of the aforesaid Settlement Agreement are fair, reasonable and adequate, whether the proposed partial settlement of the claims of the named plaintiffs in the class action and the plaintiff-intervenor in the Trustee action should be approved by the Court, and if approved, whether the fees and allowances to be applied for by the attorneys for the named plaintiffs and the plaintiff-intervenor and their respective expenses and disbursements, should be approved and allowed for payment out of the proceeds of the partial settlement.

3. Within ninety (90) days of this Order the attorneys for the named plaintiffs and plaintiff-intervenor shall give notice to the class required by Rule 23 of the Federal Rules of Civil Procedure by mailing the attached form of Notice of Pendency of Class Action and Settlement Hearing to each member of the class who can be identified through reasonable effort.

4. The amended answers of all defendants that have been filed in the class action up to and including April 19, 1976 are hereby accepted for filing.

5. All crossclaims, counterclaims, and third party claims or complaints filed or sought to be filed by leave of court by any defendant since August 25, 1975 and not otherwise previously granted by Order of this Court are hereby denied without prejudice to such claims being reasserted after trial of the class action complaint.

6. The motion for leave to file a third party complaint by the plaintiff-intervenor shall be treated by this Court as an amendment of the motion to intervene by said plaintiff-intervenor approved by this Court on November 6, 1975 and the plaintiff-intervenor is hereby granted leave to intervene in the class action to respect to those additional defendants named in the proposed third party complaint.

7. Any crossclaims, counterclaims and third party claims or complaints made by any defendant in response to the filings of the plaintiff-intervenor since August 25, 1975 are to be bifurcated and tried separately from the claims of the plaintiffs and the plaintiff-intervenor in the class action.

SIGNED and RENDERED at Dallas, Texas this 25th day of May 1976.

/s/ W. M. Taylor, Jr.
W. M. Taylor, Jr.
United States District Judge

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, THOMAS F.B. PLANT, FELTON F. WAGGONER, JACK H. BARRETT, DARYL R. LOSTAX, RALPH E. HUDDLESTON, CHESTER E. BRADLEY, JR., Plaintiffs, individually, and on behalf of all other Security Purchasers of the Securities of Texas International Speedway, Inc., Plaintiffs, and

HOWARD V. TYGRETT, JR., as Trustee of Texas International Speedway, Inc., Plaintiff-Intervenor,

vs.

LADENBURG, THALMANN & CO., a Partnership; LADENBURG, THALMANN & CO., INC., a Corporation; HERMAN & MACLEAN, Certified Public Accountants, a Partnership; SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, a Partnership; GRAHAM, LOVING & CO., INC., a Corporation; JOHN ROSENTHAL; CARL K. ERPF; JOHN F. HEIMERDINGER; ROBERT M. LEIBOWITS; EDWARD J. ROSENTHAL; MICHAEL BENNAHUM; ROBERT O. McDONALD; JAMES TRIPPE; MARILYN E. LAMARCHE; PETER DUNN; HANEY FISHNER; HERBERT L. HOCHBERG; LAWRENCE H. LOPATIN; LESLIE SHARE; LEO B. MARGOLIAN; GEORGE E. KAWAMOTO; DAN HOLLOWAY; HOLLOWAY SAND & GRAVEL COMPANY, INC., a Corporation; DAVID WITTS; THOMAS TIERNEY; an Association of Selected Dealers being comprised of the following broker-dealers; BLACK & COMPANY, INC.; BUTCHER & SHERRERD; D.H. BLAIR & COMPANY; BOETTCHER AND COMPANY;

JAMES C. BUTTERFIELD, INC.; BUTTONWOOD CORPORATION; COGAN, BERLIND, WEILL & LEVITT, INC.; DEVON SECURITIES; EDWARDS & HANLEY SECURITIES, INC.; EMANUEL, DEETJEN & CO.; FIRST OF MICHIGAN CORPORATION; FIRST MID AMERICA CORPORATION; FREEHLING & CO.; H. HENTZ & CO.; HERTZ, WARNER & CO.; HERZFELD & STERN; HIRSCH & CO.; JEN SECURITIES, INC.; KAMEN & COMPANY; KENOWER, MacARTHUR & CO.; KOHLMEYER & CO.; MANLEY, BENNETT, McDONALD & CO.; MASON & LEE, INC.; McKINNEY, ROSE & COMPANY INC.; PARKER, BISHOP & WELSCH, INC.; RAUSCHER PIERCE & CO., INC.; ROBERTS, SCOTT & CO., INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; RUSS & COMPANY, INC; SANDERS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; JOSEPH SEBAG INCORPORATED; UNDERWOOD, NEUHAUS & CO. INCORPORATED; WEBER, HALL, COBB & CAUDLE, INC.; ZUCKERMAN, SMITH & CO.; JOHN DOE; and RICHARD ROE, ET AL.,

Defendants

LADENBURG, THALMANN & CO.; JAMES TRIPPE; JOHN ROSENTHAL; HERBERT L. HOCHBERG; ROBERT O. McDONALD; CARL K. ERPF; EDWARD J. ROSENTHAL; JOHN F. HEIMERDINGER; ROBERT LIEBOWITS; PETER DUNN; DEVON SECURITIES; ZUCKERMAN, SMITH & CO.; ROBERTS, SCOTT & CO., INC.; COGAN, BERLIND, WEILL & LEVITT, INC.; JAMES C. BUTTERFIELD, INC.; FREEHLING & CO.; HERZFELD & STERN; MASON & LEE, INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; KENOWER, MacARTHUR & CO.; FIRST OF MICHIGAN CORPORATION; BLACK & COMPANY, INC.; D. H. BLAIR

& COMPANY; EMANUEL, DEETJEN & CO.; H. HENTZ & CO.; JOSEPH SEBAG INCORPORATED; MANLEY, BENNETT, McDONALD & CO.; HERTZ, WARNER & CO.; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, BOETTCHER AND COMPANY; BUTCHER & SHERRERD; FIRST OF MID AMERICA CORPORATION; KOHLMEYER & CO.; McKINNEY, ROSE & COMPANY INC.; RAUSCHER PIERCE & CO., INC.; RUSS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; AND UNDERWOOD, NEUHAUS & CO. INCORPORATED Third Party Plaintiffs, vs. TALBOT RAIN, as Trustee of Texas International Speedway, Inc.; EDSEL BURKHART; M. RICHARD HERMAN; THOMAS TIERNEY; DAVID WITTS; ROWLES-WINSTON & CO., INC.; ED DRYDEN; JOHN S. TUSCHMAN; RICHARD RADY; JACK FALLAS; WILLIAM ACKLEY and PAT ROWLES; Third Party Defendants.	)

This Notice is given pursuant to Rule 23 of the Federal Rules of Civil Procedure, and pursuant to an Order of the United States District Court for the Northern District of Texas (the "Court"), filed May , 1976, to all persons, except the named defendants, who purchased securities of Texas International Speedway, Inc. (referred to hereinafter as the "Company" or "TIS") and suffered damages as a result thereof during the period beginning October 30, 1969, and ending January 28, 1970. Such persons are collectively called the "Class".

You are *not* being sued. This notice is being sent to you so that you may take steps to protect your rights. *By this Notice, the Court does not express any opinion regarding*

the merits of the above entitled action. This Notice is intended solely to inform you about the nature of the action, its essential allegations, a settlement of the action as to certain named defendants, and the steps you might wish to take concerning the possible effect on any claim you, as a potential member of the Class, may have against the named defendants.

The above entitled action asserts claims, individually, and by certain of the named plaintiffs on behalf of the Class, against named defendants who allegedly participated, directly or indirectly, in the preparation and filing of the registration statement and prospectus of the Company with the United States Securities and Exchange Commission and the Texas State Securities Board under the terms of which certain TIS securities (consisting of "Units", common stock and debentures) were offered and sold to the public during the period beginning on or about October 30, 1969 and ending January 28, 1970, which date marked the end of the ninety day period during which the prospectus was required to be kept effective.

This class action has been brought under the provisions of the Securities Act of 1933, as amended, the Securities and Exchange Act of 1934, as amended, and the Texas Securities Act of 1957, as amended. The complaint in this class action alleges in substance that all or some of the named defendants are directly or indirectly responsible for or had knowledge of or should have had knowledge of certain alleged false and misleading statements and material omissions in the registration statement and prospectus of the Company initially made effective and dated as of October 30, 1969, and subsequently amended on November 12, 1969, and December 23, 1969, and that the named plaintiffs and the Class suffered damages by purchasing TIS securities in reliance upon information obtained

from such alleged misleading amended registration statement and prospectus. The complaint in this class action also alleges that certain of the defendants had violated fiduciary duties owed to the plaintiffs and used their insider relationship with the Company to the detriment of the named plaintiffs and the Class.

The named defendants include the managing underwriter, its partners and alleged successor corporation, all of the selected broker-dealers who participated in the firm underwriting of TIS securities at the time of the initial public offering on or about October 30, 1969, the attorneys for the underwriters, the officers and directors of the Company, the certified public accountants for the Company, the general contractor who received the bulk of the proceeds of the sales of TIS securities and subsequently obtained title to the real property of the Company, the engineering consulting firm for the Company and certain other individuals and corporations affiliated with the other named defendants. The defendants have denied all the allegations of the complaint. In addition, certain of the defendants have cross-claimed against other defendants and third-party complaints have been filed against persons not named as defendants in the original complaint. For purposes of pretrial discovery only, the above entitled action has been consolidated with the related pending case entitled *Talbot Rain, as Trustee of Texas International Speedway, Inc. v. American Raceways, Inc., et al.*, index number CA 3-5281-C. In addition, the Trustee for TIS has been permitted to intervene in this class action as a plaintiff with respect to certain named defendants.

The Court has ruled that the above entitled action shall proceed, pursuant to the provisions of Rule 23 of the Federal Rules of Civil Procedure, as a class action on behalf of the Class described in the first paragraph of this

Notice. Such ruling is procedural in nature, and, as previously stated, the Court expresses no opinion regarding the merits of the claims made by the plaintiffs in this class action. Certain of the named plaintiffs, by their attorneys, will represent the Class in all subsequent proceedings. If you are a potential member of the Class, you do not have to appear personally or by your attorney to be considered a party.

In order to avoid incurring substantial additional expenditures of time and money by the settling defendants and to reduce the number of defendants and thereby reduce the expenditure of time and money by the named plaintiffs and the Class, a written agreement (hereinafter referred to as the "Settlement Agreement") has been entered into by and between the named plaintiffs and certain named defendants (hereinafter referred to collectively as the "settling defendants") to settle this class action and the above described action filed by the Trustee for TIS as to the settling defendants.

The proposed partial settlement will not affect the rights of the named plaintiffs and the class to continue this class action against the other named defendants.

The named plaintiffs and settling defendants have submitted the Settlement Agreement to the Court for approval as a partial settlement of the claims set forth in the class action complaint and for dismissal of the complaint filed by the Trustee for TIS against certain of the settling defendants. The Settlement Agreement provides that the settling defendants shall pay $275,000 for distribution to the named plaintiffs and members of the Class who establish claims of damage and for payment to the attorneys and legal representatives of the named plaintiffs and the Trustee for TIS of such fees and expenses as will

be allowed by the Court in full and final settlement of all claims against the settling defendants which are alleged in the complaint in this class action or could have been alleged by reason of or in connection with any matter or fact set forth or referred to in the complaint filed by the Trustee for TIS.

In the event that the Settlement Agreement is approved and becomes effective, this class action as to the settling defendants will be dismissed with prejudice and all members of the Class (other than those persons who elect to be excluded from the Class) will be barred and permanently enjoined from asserting against the settling defendants (and their respective predecessors, successors, affiliates, officers, directors, partners, employees, agents, heirs, assigns and representatives) any and all claims, demands or causes of action which are alleged or could have been alleged by reason of or in connection with any matter of fact set forth or referred to in the class action complaint and the complaint filed by the Trustee for TIS.

Promptly after approval of the Settlement Agreement, and entry of an order in the class action approving the aforesaid partial settlement and this form of Notice of Pendency of Class Action and Settlement Hearing, the settling defendants shall pay $275,000 to the Clerk of the Court or such other depository as the Court may direct.

No payments will be made to the named plaintiffs, the Class or the Trustee for TIS until all of the conditions set forth in the Settlement Agreement have been satisfied, including that the Court finally approve the amount of fees, costs and disbursements for the attorneys and legal representatives of the named plaintiffs and the Trustee for TIS and enter as to the settling defendants a final order and judgment of dismissal with prejudice against the

plaintiffs in this class action and all members of the Class who have not timely excluded themselves.

Under the terms of the Settlement Agreement, provision has been made to indemnify and defend the settling defendants against possible claims of other defendants for indemnification and/or contribution that would result from any judgments entered against such other defendants in the above entitled action or any related proceeding. This provision is to be funded by an escrow depository for payments received arising out of judgments against or settlements obtained from defendants other than the settling defendants, if any, where such defendants do not waive claims of indemnity or contribution against the settling defendants. Any final judgment against any settling defendant, in favor of any other defendant, for a claim of contribution and/or indemnity or any settlement of such claim, shall be paid out of the escrow depository.

The Court has tentatively approved the Settlement Agreement as fair, reasonable and adequate.

Pursuant to Rule 23(c)(2) of the Federal Rules of Civil Procedure, you are hereby given notice that you have the following rights:

1. *The Right to be Excluded:* If you are a potential member of the Class as described in the first paragraph of this Notice, you have the right to request that the Court exclude you from this class action. Persons who request exclusion will not be entitled to share in the benefits of any settlement or judgment if it is favorable to the named plaintiffs and the Class, and will not be bound by any judgment if it is adverse to the named plaintiffs and the Class. *Persons who request exclusion may not file, or participate in, any other class action in respect to his claim* but may attempt to pursue his claim individually, subject to

any defenses that might be asserted against such individual claim. To be excluded, you *must* notify the Clerk of the Court on or before the 15th day of August, 1976. You may do this by simply sending a postcard or letter to the Honorable Joseph McElroy, Jr., Clerk of the Court of the United States District Court for the Northern District of Texas, Federal Building, 1100 Commerce Street, Dallas, Texas 75202. You should state that "I, (your name) elect to be excluded from the Class in the case of *David M. Kemp, et al. v. Ladenburg, Thalman & Co., et al.*, CA 3-6677-C". Please sign and date the postcard or letter.

2. *The Right to Appear by Counsel:* If you are a potential member of the Class and do not wish to elect to be excluded, you may, if you desire, enter an appearance in this class action through counsel of your own choosing. If you do not request exclusion and do not enter an appearance through your own counsel, your interests will be represented by the named plaintiffs, by their counsel, as attorneys for the Class.

You are hereby given notice of the effect of a judgment in this class action: If you are a potential member of the Class and do not request exclusion you will be included in the Class and be bound by a judgment in the above entitled action whether it be favorable or unfavorable. You will also be bound by any settlement in this class action approved by the Court including the partial settlement with the settling defendants described above. Regardless of the outcome of this class action, you will *not* have to pay any fees and expenses of the attorneys for the named plaintiffs as class representatives. If the named plaintiffs are successful, the attorneys for the named plaintiffs will be paid out of any recovery obtained for the Class.

3. A hearing will be held before the Court in Room

15D2811, Federal Building, 1100 Commerce Street, Dallas, Texas 75202, on September 17, 1976 at 9:30 A.M. or as soon thereafter as counsel can be heard for the purpose of determining whether the terms of the Settlement Agreement are fair, reasonable and adequate, whether the proposed partial settlement of the claims in this class action should be approved by the Court, and if approved, for the purpose of entering judgment thereon in accordance with the Settlement Agreement, and whether the fees and allowances applied for in this class action by the attorneys for the named plaintiffs and the Trustee of TIS and their respective expenses and disbursements, should be approved by the Court and allowed for payment out of the proceeds of the partial settlement. The hearing may be adjourned from time to time without further notice to the Class.

4. The Court has been advised that at the hearing on the proposed partial settlement the attorneys for the named plaintiffs in this class action will apply to the Court, out of the $275,000 to be paid in partial settlement by the settling defendants, for an interim allowance of fees in an aggregate approximate amount of $50,000 and for reimbursement of expenses and disbursements in the approximate amount of $15,000 and that the attorneys for the Trustee for TIS will apply to the Court for an allocation of approximately $32,500 of the partial settlement to the complaint filed by the Trustee and out of such allocation an award of fees in the approximate amount of $15,000 and for reimbursement of expenses and disbursements in the approximate amount of $2,500.

5. The Settlement Agreement and all other papers filed in this class action may be examined and copied at any time during regular office hours at the Office of the Clerk, United States District Court Northern District of Texas,

Federal Building, 1100 Commerce Street, Dallas, Texas 75202.

6. Any member of the Class who did not notify the Clerk of the Court of his wish to be excluded from the Class may appear at the hearing on the proposed partial settlement and show cause why the Settlement Agreement in this class action should not be approved as fair, reasonable and adequate, why judgment thereon dismissing this class action against the settling defendants should not be entered, and why the application by the attorneys for the named plaintiffs and the Trustee for TIS for fees, allocation of the proceeds of the partial settlement, and reimbursement of expenses and disbursements should not be approved. Any member of the Class who wishes to object to the proposed partial settlement, however, must first file written objections with the Clerk of the Court of the United States District Court, Northern District of Texas, Dallas Division, Federal Building, 1100 Commerce Street, Dallas, Texas 75202, not later than the 15th day of August, 1976 showing delivery of a copy of the written objections to the following attorneys for the named plaintiffs and the Trustee for TIS:

Robert H. Jaffe, P.A.
8 Mountain Avenue
Springfield, New Jersey 07081

Lieberman & Komiss, Esqs.
1515 Bank of the Southwest Building
Houston, Texas 77022

Tygrett, Simpson & Florence, Esqs.
715 Preston Bank Building
Dallas, Texas 75225

and delivery of a copy of the written objections to the following lead attorneys for the settling defendants:

Clark, West, Keller, Sanders & Butler, Esqs.
2424 First National Bank Building
Dallas, Texas 75202

Rosenman Colin Freund Lewis & Cohen
575 Madison Avenue
New York, New York 10022

Carrington Coleman, Sloman, Johnson & Blumenthal, Esqs.
3000 One Main Place
Dallas, Texas 75250

Any papers filed with the Court and delivered to the above designated attorneys must bear the name of this class action. *"David Kemp, et al. v. Ladenburg, Thalmann & Co., et al.*, and its index number "CA 3-6677-C". The postmark on the envelope will determine whether any papers mailed to the Court for filing with copies to the above designated attorneys are timely.

7. No person shall be entitled in any way to contest the approval of the terms and conditions of the Settlement Agreement, or the judgment entered thereon if approved, unless he has first served and filed written objections with the Court with copies to the above designated attorneys in accordance with the provisions of the preceding paragraph.

If you require further information or have any questions concerning this Notice, the litigation described in this Notice or the partial settlement of this class action, you may contact the Honorable Joseph McElroy, Jr., Clerk of the United States District Court for the Northern District of Texas.

Do not call or write to Judge W. M. Taylor, Jr.

Dated May 25th, 1976

/s/ W. M. Taylor, Jr.
W. M. Taylor, Jr.
United States District Judge

ORDER AND JUDGMENT APPROVING PARTIAL SETTLEMENT
(Filed 9/17/76)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, THOMAS F.B. PLANT, FELTON F. WAGGONER, JACK H. BARRETT, DARYL R. LOSTAX, RALPH E. HUDDLESTON, CHESTER E. BRADLEY, JR. Plaintiffs, individually, and on behalf of all other Security Purchasers of the Securities of Texas International Speedway, Inc., Plaintiffs, and

HOWARD V. TYGRETT, JR. as Trustee of Texas International Speedway, Inc., Plaintiff-Intervenor

vs.

LADENBURG, THALMANN & CO., a Partnership; LADENBURG & THALMANN CO., INC., a Corporation; HERMAN & MACLEAN, Certified Public Accountants, a Partnership; SPENCER J. BUCHANAN & ASSOCIATES, INC., a Corporation; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, a Partnership; GRAHAM, LOVING & CO., INC., a Corporation; JOHN ROSENTHAL; CARL K. ERPF; JOHN F. HEIMERDINGER; ROBERT M. LEIBOWITS; EDWARD J. ROSENTHAL; MICHAEL BENNAHUM; ROBERT O. McDONALD; JAMES TRIPPE; MARILYN E. LAMARCHE; PETER DUNN; HANEY FISHNER; HERBERT L. HOCHBERG;

LAWRENCE H. LOPATIN; LESLIE SHARE; LEO B. MARGOLIAN; GEORGE E. KAWAMOTO; DAN HOLLOWAY; HOLLOWAY SAND & GRAVEL COMPANY, INC., a Corporation; DAVID WITTS; THOMAS TIERNEY; an Association of Selected Dealers being comprised of the following broker-dealers: BLACK & COMPANY, INC.; BUTCHER & SHERRERD; D.H. BLAIR & COMPANY; BOETTCHER AND COMPANY; JAMES C. BUTTERFIELD, INC.; BUTTONWOOD CORPORATION; COGAN, BERLIND, WEILL & LEVITT, INC.; DEVON SECURITIES; EDWARDS & HANLEY SECURITIES, INC.; EMANUEL, DEETJEN & CO.; FIRST OF MICHIGAN CORPORATION; FIRST MID AMERICA CORPORATION; FREEHLING & CO.; H. HENTZ & CO.; HERTZ, WARNER & CO.; HERZFELD & STERN; HIRSCH & CO.; JEN SECURITIES, INC.; KAMEN & COMPANY; KENOWER, MacARTHUR & CO.; KOHLMEYER & CO.; MANLEY, BENNETT, McDONALD & CO.; MASON & LEE, INC.; McKINNEY, ROSE & COMPANY INC.; PARKER, BISHOP & WELSCH, INC.; RAUSCHER PIERCE & CO., INC.; ROBERTS, SCOTT & CO., INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; RUSS & COMPANY, INC; SANDERS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; JOSEPH SEBAG INCORPORATED; UNDERWOOD, NEUHAUS & CO. INCORPORATED; WEBER, HALL, COBB & CAUDLE, INC.; ZUCKERMAN, SMITH & CO.; JOHN DOE; and RICHARD ROE, ET AL.,

Defendants,

LADENBURG, THALMANN & CO.; JAMES TRIPPE; JOHN ROSENTHAL; HERBERT L. HOCHBERG; ROBERT O. McDONALD; CARL K. ERPF; EDWARD J. ROSENTHAL; JOHN F. HEIMERDINGER; ROBERT LIEBOWITS; PETER DUNN; DEVON SECURI-

TIES; ZUCKERMAN, SMITH & CO.; ROBERTS, SCOTT & CO., INC.; COGAN, BERLIND, WEILL & LEVITT, INC.; JAMES C. BUTTERFIELD, INC.; FREEHLING & CO.; HERZFELD & STERN; MASON & LEE, INC.; THE ROBINSON-HUMPHREY COMPANY, INC.; ROSENTHAL & CO.; KENOWER, MacARTHUR & CO.; FIRST OF MICHIGAN CORPORATION; BLACK & COMPANY, INC.; D. H. BLAIR & COMPANY; EMANUEL, DEETJEN & CO.; H. HENTZ & CO.; JOSEPH SEBAG INCORPORATED; MANLEY, BENNETT, McDONALD & CO.; HERTZ, WARNER & CO.; ROSENMAN, COLIN, KAYE, PETSCHEK, FREUND & EMIL, BOETTCHER AND COMPANY; BUTCHER & SHERRERD; FIRST OF MID AMERICA CORPORATION; KOHLMEYER & CO.; McKINNEY, ROSE & COMPANY INC.; RAUSCHER PIERCE & CO., INC.; RUSS & COMPANY, INC.; SCHNEIDER, BERNET & HICKMAN SECURITIES CORPORATION; and UNDERWOOD, NEUHAUS & CO. INCORPORATED,

Third Party Plaintiffs

vs.

TALBOT RAIN, as Trustee of Texas International Speedway, Inc.; EDSEL BURKHART; M. RICHARD HERMAN; THOMAS TIERNEY; DAVID WITTS; ROWLES-WINSTON & CO., INC.; ED DRYDEN; JOHN S. TUSCHMAN; RICHARD RADY; JACK FALLAS; WILLIAM ACKLEY and PAT ROWLES;

Third Party Defendants.

The Court having determined on August 25, 1975 (1) that this action may be maintained as a class action on behalf of all persons (other than the named defendants in this class action) who purchased securities of Texas International Speedway, Inc. ("TIS") (a) at the original offering on or about October 30, 1969 and (b) in the 90 day period

ending January 28, 1970 following the original public offering date (the "Class"), (2) that of the named plaintiffs in this class action plaintiffs Ralph E. Huddleston and Chester E. Bradley, Jr. fairly and adequately represent the interests of the members of the above described and designated class of TIS security purchasers and (3) that notice to the Class required by Rule 23 of the Federal Rules of Civil Procedure should be given to each class member who can be identified through reasonable effort; and an Order of the Court having been entered on May 25, 1976, after a hearing, tentatively approving the settlement of the claims asserted or which could have been asserted by the named plaintiffs, the Class and Howard V. Tygrett, Jr., as Trustee in Bankruptcy for TIS (the "Trustee") in an action entitled *Talbot Rain, as Trustee of Texas International Speedway, Inc. v. American Raceways, Inc. et al.*, index number CA 3-5281-C (the "Trustee action") and as plaintiff-intervenor in this class action against all or any of the defendants named on Schedule "A" attached to this Order (such defendants and their predecessors, successors, affiliates, partners, officers, directors, shareholders, employees, agents, heirs, assigns and representatives, are hereinafter referred to collectively as the "settling defendants"), and approving a Notice of Pendency of Class Action and Settlement Hearing ("Notice") to be mailed to each class member who can be identified through reasonable effort, which, *inter alia*, gave notice of the proposed partial settlement of this class action as to the settling defendants and tentative approval of the settlement by the Court; and a hearing having been held on September 17, 1976 to determine whether the terms of the proposed partial settlement were fair, reasonable and adequate, whether the written agreement (the "Settlement Agreement") entered into by and among the parties dated as of May 25, 1976 to the proposed partial settlement should be

approved by the Court and judgment entered thereon in accordance with its terms, and whether fees and allowances as applied for by the attorneys for the named plaintiffs and the Trustee, and their respective expenses and disbursements, should be approved by the Court and awarded for payment out of the proceeds of the partial settlement, and the Court having considered the Applications For Compensation filed by the attorneys for the named plaintiffs and the designated class, as well as affidavits and other submissions relating to the reasonable effort made to mail the Notice to potential class members and the response to such mailing; and the Court having considered the effect on the non-settling defendants of the approval of this partial settlement; and it appearing that in accordance with the provisions of Rule 54(b) of the Federal Rules of Civil Procedure the Court should expressly determine whether there is just reason for delay for the entry of final judgment as to the settling defendants; and the Court having considered the pleadings and memorandums previously filed in this class action and after having heard argument of counsel; and for other good cause shown; it is accordingly

ORDERED, ADJUDGED AND DECREED as follows:

1. The Settlement Agreement, including the Escrow Agreement attached thereto, whereby the claims asserted or which could have been asserted by the named plaintiffs, the Class and/or Howard V. Tygrett, Jr., as plaintiff in the Trustee action and as plaintiff-intervenor in this class action against the settling defendants identified on Schedule "A" attached to this Order, is hereby approved and confirmed as being fair, reasonable and adequate, and the parties thereto are hereby directed to perform the Settlement Agreement in accordance with its terms.

2. Out of the sum of $275,000 paid by the settling defendants in partial settlement of this class action and the Trustee action, pursuant to the request made in their respective Applications For Compensation, which were supported by affidavits and an accounting of legal services rendered, time expended and disbursements incurred, the law firms of Robert H. Jaffe, P.A. and Lieberman & Komiss, Esqs., on behalf of all attorneys of record for the plaintiffs and the Class as designated by this Court, are hereby awarded and granted an interim allowance of $60,000 for attorney's fees; the law firm of Robert H. Jaffe, P.A. is hereby awarded the sum of $13,453.85 as reimbursement of expenses and disbursements incurred through August 31, 1976; and the law firm of Lieberman & Komiss, Esqs. is hereby awarded the sum of $6,618.13 as reimbursement of expenses and disbursement incurred through August 31, 1976. The Court has determined that the aforesaid interim awards of attorney's fees and disbursements to the attorneys for the named plaintiffs and the Class are reasonable and appropriate after consideration of the complexity of this litigation, the time expended by the aforesaid law firms and the results achieved.

3. Out of the sum of $275,000 paid by the settling defendants in partial settlement of this class action and the Trustee action, pursuant to the terms of the Settlement Agreement, Howard V. Tygrett, Jr., Esq., on behalf of the Trustee and in consideration for the settlement of all claims against the settling defendants and the dismissal with prejudice of the Trustee action against certain of the settling defendants, is hereby awarded the sum of $32,500. The Court has determined that the allocation to the settlement of the Trustee action of $32,500 out of the $275,000 paid pursuant to the partial settlement is fair and

reasonable and that the aforesaid award of attorney's fees and disbursements to Howard V. Tygrett, Jr., Esq. is reasonable.

4. The balance of the $275,000 paid pursuant to the Settlement Agreement and partial settlement of this class action shall be placed in an interest bearing escrow account at the main office of the Houston National Bank, Tenneco Building, Houston, Texas 77001 for the benefit of the named plaintiffs and those members of the Class who shall prove their damage claims in accordance with a claim procedure to be submitted for approval of the Court within sixty days by the attorneys for the named plaintiffs and the Class. There shall be no withdrawals from said escrow account except as provided in this Order until further order of this Court.

5. The Court specifically approves reimbursement of disbursements made by the attorneys for the named plaintiffs and the Class for the costs of mailing the Notice from the proceeds of the partial settlement and paragraph 7 of the Order Granting Class Action Determination distributed to all counsel of record on August 25, 1975 providing that "The plaintiffs shall bear the costs of notice to the class" is hereby deemed to be corrected, modified and superceded.

6. In the event that the amounts paid by the settling defendants and any other defendant in this class action to the named plaintiffs, the Class and/or the Trustee pursuant to this Order and Judgment and any other agreement, order or judgment of the Court, plus all income earned thereon, exceeds the sum of the allowed claims (including any interest allowed thereon) of all the named plaintiffs, the Class and the Trustee, plus the total of all fees, expenses and disbursements of the attorneys for the

named plaintiffs, the Class and the Trustee allowed by the Court, then a portion of said excess shall be returned to the settling defendants in the proportion that said payments by the settling defendants bears to the total of payments by all defendants in this class action.

7. It has been determined that members of the Class (other than the named defendants) who have elected to be excluded from this class action purchased in the aggregate not more than 33,000 shares of TIS stock or $330,000 in face amount of TIS debentures.

8. Any member of the Class who has elected to be excluded from this class action may not file, or participate in, any other class action in respect to his claim but may pursue his claim individually, subject to any defenses that might be asserted against any such individual claim.

9. All claims against the settling defendants by anyone who might fall within the Class, except those persons who have elected to be excluded from the Class, are forever barred.

10. Pursuant to the provisions of the Settlement Agreement, all claims which have been or could be asserted by the named plaintiffs, the Class and/or the Trustee against each and every one of the settling defendants in this class action and in the Trustee action are dismissed with prejudice with costs to be paid by each party that has incurred same.

11. The effect of the approval by the Court of the partial settlement is not to release or discharge any named defendant who is not a party to the Settlement Agreement from liability to the named plaintiffs, the Class and/or the Trustee, it being the determination of the Court that the release of any of the settling defendants is not to be treated

as the release of a joint tort-feasor under common law.

12. The partial settlement of $275,000, with the $32,500 paid in settlement of the Trustee's action, shall constitute only a *pro tanto* reduction with respect to any judgment that the named plaintiffs, the Class and/or the Trustee may recover in the future against the non-settling defendants in this class action, said determination to be subject to modification for good cause shown at the time such judgment, if any, is recovered against the non-settling defendants.

13. All counterclaims, crossclaims and third party complaints filed or joined in by any settling defendants in this class action or the Trustee action and all pending motions pertaining thereto are hereby dismissed without prejudice with costs to be borne by each party that has incurred same.

14. The settling defendants shall continue to produce their respective representatives for oral examination before trial, with such documents as may be reasonably requested, and to otherwise respond to discovery proceedings as if, and to the extent, that each was still a defendant to the class action and the Trustee action and to produce appropriate representatives as witnesses for the plaintiffs at the trial of the class action and the Trustee action to the same extent as if each settling defendant would have been required if he had remained a named defendant therein.

15. Pursuant to the provisions of Rule 54(b) of the Federal Rules of Civil Procedure, the Court has determined there is no just reason for delay of entry of final judgment in this class action dismissing with prejudice all claims which have been or could have been asserted by the

named plaintiffs, the Class and/or the Trustee against each and every one of the settling defendants in this class action and the Trustee action and expressly directs the entry of this Order as a final adjudication of all claims, rights and liabilities as between the named plaintiffs, the Class and the Trustee and the settling defendants subject only to adherence by the settling defendants to the other provisions of this Order.

SIGNED and RENDERED at Dallas, Texas, this 17th day of September, 1976.

/s/ W. M. Taylor, Jr.
W. M. Taylor, Jr.
United States District Judge

SCHEDULE "A" OF DEFENDANTS DESIGNATED AS "SETTLING DEFENDANTS" IN THE "ORDER AND JUDGMENT APPROVING PARTIAL SETTLEMENT, ETC." IN THE CASE ENTITLED DAVID A. KEMP, et al., PLAINTIFFS v. LADENBURG, THALMANN & CO., et al., INDEX NO. CA 3-6677-C

A. Settling defendants represented by Clark, West, Keller, Sanders & Butler, Esqs.:

Ladenburg, Thalmann & Co., a Partnership; James Trippe; John Rosenthal; Herbert L. Hochberg; Robert O. McDonald; Carl K. Erpf; Edward J. Rosenthal; John F. Heimerdinger; Robert Leibowits; Peter Dunn; Marilyn E. LaMarche; Michael Bennahum; Devon Securities; Zuckerman, Smith & Co.; Roberts, Scott & Co., Inc.; Cogan, Berlind, Weill & Levitt, Inc.; James C. Butterfield, Inc.; Freehling & Co.; Herzfeld & Stern; Mason & Lee, Inc.; The Robinson-Humphrey Company, Inc.; Rosenthal & Co.; Kenower, MacArthur & Co.; First of Michigan Corporation; Black & Company, Inc.; D. H. Blair & Company; Emanuel, Deetjen & Co.; H. Hentz & Co.; Joseph Sebag Incorporated; Manley, Bennett, McDonald & Co.; Hertz, Warner & Co.; and Haney Fishner.

B. Settling defendants represented by Carrington, Coleman, Sloman Johnson & Blumenthal, Esqs.:

Boettcher and Company; Butcher & Sherrerd; First Mid America Corporation; Kohlmeyer & Co.; McKinney, Rose & Company, Inc.; Rauscher Pierce & Co., Inc.; Russ & Company, Inc.; Schneider, Bernet & Hickman Securities Corporation; and Underwood, Neuhaus & Co., Incorporated.

C. Settling defendants represented by Rosenman Colin Freund Lewis & Cohen, Esqs.:

Rosenman, Colin, Kaye, Petschek, Freund & Emil and Ladenburg, Thalmann & Co., Inc.

D. Settling defendant represented by Edward Garber, Esq.: Kamen & Company.

E. Settling defendant represented by Golden, Potts, Boeckman & Wilson, Esqs.:

Weber, Hall, Cobb & Caudle, Inc.

F. Settling defendant represented by Haynes & Boone, Esqs.: Sanders & Company, Inc.

G. Settling defendant represented by Dean Carlton, Esq.:

Edwards & Hanley Securities, Inc.

H&M'S EXCEPTIONS TO THE CHARGE OF COURT AND VERDICT (TO WHICH IS ATTACHED DEFENDANTS' REQUESTED JURY INSTRUCTIONS AND ISSUES DATED 6/25/79 REFERRED TO THEREIN)

(Filed 7/3/79)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, ET AL, Plaintiffs,	)
vs.	)
LADENBURG, THALMANN & CO., ET AL., Defendants	)

EXCEPTIONS TO THE CHARGE OF COURT AND VERDICT

TO THE HONORABLE JUDGE OF SAID COURT:

NOW COMES HERMAN & MacLEAN, a defendant in the above-styled and numbered cause, and submits herewith its exceptions to the charge of Court as proposed to be submitted:

1. This Defendant excepts to the failure to submit a special issue on the question of reliance along the lines of Special Issue No. 2 set forth in the proposed Charge of the Court and Verdict of the Jury submitted by this Defendant in this proceeding on June 25, 1979, a copy of which is attached to these Exceptions for the convenience of the Court.

2. This Defendant excepts to the failure to submit an issue on causation in fact in substantially the form of Special Issue No. 3 submitted by this Defendant in its proposed Charge to the Court and Verdict of the Jury attached hereto as an exhibit. In this connection, this Defendant would call to the attention of the Court the holding of United States Supreme Court in *Piper v. Chris Craft Industries*, 430 U.S. 1 (1977), as stated in the following language:

> Standards for proving causation in a securities law case were established in Mills v. Electric Auto-Lite Co., 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970), and in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972). It must be shown that the misstatement or omission is 'material.' That term most recently has been defined by this Court to mean that 'the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.' *TSC Industries, Inc. v. Northway, Inc.* 426 U.S. 438, 449, 96 S.Ct. 2121, 2133, 48 L.Ed.2d 757 (1976)***
>
> *Affiliated Ute Citizens*, of course, did not abolish the requirement of causation in failure-to-disclose cases. It simply provided the causal link between the omission of material information and the shareholder's act of purchasing or selling stock.

This Defendant would also call to the attention of the Court the following language of the Eighth Circuit Court of Appeals in *St. Louis Union Trust Company v. Merrill Lynch Pierce Fenner & Smith*, 562 F.2d 1040, *cert. denied* 435 U.S. 925:

> Causation in fact is an essential element of a private cause of action for securities fraud under

sec. 10(b) and Rule 10b-5. *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 154, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith,* 495 F.2d 228, 238 (2d Cir. 1974); *Harris v. American Investment Co.,* 523 F.2d 220, 229 n. 7 (8th Cir. 1975), *cert. denied,* 423 U.S. 1054, 96 S.Ct. 784, 46 L.Ed.2d 643 (1976); *Fridrich v. Bradford,* 542 F.2d 307, 318 (6th Cir. 1976), *cert. denied,* 429 U.S. 1053, 97 S.Ct. 767, 50 L.Ed.2d 769 (1977). *See generally,* A. Bromberg, *Securities Law, Fraud-SEC Rule 10b-5,* sec. 8.7(1) at 213-214 (1967). In order to prevail in an action for securities fraud under sec. 10(b) and Rule 10b-5, a plaintiff must show some causal nexus between the defendant's wrongful conduct and his (the plaintiff's) loss.[11] This requirement preserves the basic concept that causation must be proved else defendants could be held liable to all the world. (Omitting authorities)***

The roots of the causation in fact requirement have been the subject of much disharmony. Causation has been most often analyzed in terms of the Rule 10b-5 elements of materiality or reliance. *See, e.g., Affiliated Ute Citizens v. United States, supra,* 406 U.S. at 153-154, 92 S.Ct. 1456 (materiality); *List v. Fashion Park, Inc., supra,* 340 F.2d at 462 (reliance). The materiality element requires the plaintiff to show that the misrepresentation or omission would likely have influenced in reasonable or objective contemplation the seller's decision to sell. *Cf. TSC Industries v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). The element of reliance traditionally required proof that the misrepresentation or omission actually induced the plaintiff to act differently than he

> would have acted in his investment decision. (Omitting Authorities)***
>
> Whether we analyze the causation issue before us in terms of materiality, reliance or both, the result is the same: causation in fact does not exist as a matter of law under sec. 10(b) and Rule 10b-5. Any 'loss' which was occasioned by the sale of the Bitting stock to the corporation was not caused by any material omission, fraudulent or otherwise, on the part of the defendants. The purported 'loss' was caused by two events unrelated to the alleged fraud***.

562 F.2d at 1048, 1049.

Finally, this Defendant would point out the language of the Fifth Circuit in *Herpich v. Wallace,* 430 F.2d at p. 810, in which the Fifth Circuit stated as follows:

> The gist of a Rule 10b-5 action for damages is economic injury to the plaintiff resulting proximately from the acts of the defendant which constitute a violation of the rule.

3. This Defendant objects to the submission of any issues whatever dealing with the application of the Texas Securities Act, for the reason that compliance with the Texas Securities Act is an issue which is not common to the class and the submission of provisions and definitions of the Texas Securities Act will be prejudicial to this Defendant. In particular, this Defendant would point out to the Court that the prospectus of Texas International Speedway dated October 30, 1969, reflects on pp. 25 through 27 that the members of the underwriting group were located in thirteen different states. Such pages also indicate that of the 37 members of the underwriting group, a total of only six were located in the State of Texas and that of the 3,300 units of debentures and shares of com-

mon stock offered to the public, a total of only 525 (representing 15.9 percent out of the total) were offered for sale by underwriters located in the State of Texas. There has been no evidence presented as to the number of resales in the secondary market and the portion of resales occurring in the State of Texas as compared with resales in other states. In the case *Enntex Oil & Gas Co. (of Nevada) v. State,* 560 S.W.2d 494 (Tex.Civ.App. 1977), which is the principal authority relied upon by the Plaintiffs, the court stated as follows:

> The Texas Securities Act applies only to disposition of securities within the state and accordingly, only incidentally touches interstate commerce.

Since it is clear that the majority of the dispositions of securities by Texas International Speedway during the class period were in transactions outside the State of Texas, the issue of violations of the Texas Securities laws cannot be an issue which is common to the class and its submission is prejudicial to this Defendant.

This Defendant further objects to the submission of instructions or issues pertaining to the Texas Securities Act because there is no evidence that this Defendant was a seller of a security or that this Defendant engaged in any act by which a sale was made. The cases relied upon by the Plaintiffs are each cases in which the defendants were engaged in selling activities such as making telephone calls from and sending correspondence from a principal office in the State of Texas. It was held that these actions invoked the power of the State Securities Board in order to enjoin the fraudulent conduct of Texas citizens. There is no Texas case holding that a nonresident of the State of Texas purchasing securities through a member of an underwriting group or a broker or dealer in a transaction outside of the State of Texas may bring a private right of action

merely on the grounds that the issuer of the securities is incorporated in the State of Texas or on the grounds that proceeds of a public offering were to be used for construction of a project located within the State of Texas.

4. This Defendant further objects to that portion of the charge which refers to any materials filed with the Securities and Exchange Commission other than the prospectus of Texas International Speedway dated October 30, 1969. There is no evidence showing or tending to show that any member of the class received, reviewed, relied upon, or was in a position to rely upon, any materials filed with the Securities and Exchange Commission except for the prospectus dated as of October 30, 1969. Therefore, that portion of the instructions referring to the Registration Statement and containing the instruction that the Registration Statement includes the exhibits and the prospectus dated October 30, 1969, is in error and is prejudicial to this Defendant.

5. This Defendant objects to the submission of Special Issue 1(b) for the reason that the prospectus dated October 30, 1969, does not reflect at any place the working capital position of Texas International Speedway on October 30, 1969. The prospectus does reflect, by means of a pro forma balance sheet dated May 31, 1969, the financial condition of Texas International Speedway as of May 31, 1969, giving effect only to the pro forma adjustments described; the pro forma balance sheet is not dated as of October 30, 1969, and does not purport to reflect the actual financial condition of Texas International Speedway on October 30, 1969. Further, to the extent that Special Issue 1(b), reflects merely that the working capital position of Texas International Speedway was based upon an estimated use of proceeds, the submission of Special Issue 1(b) is duplicative of the matters submitted in Special Issue 1(a) and Special Issue 1(b) should therefore not be submitted.

6. This Defendant objects to the submission of Special Issue 1(d) as to this Defendant for the reason that there is no evidence which might support any finding that the representation referred to in Special Issue 1(d) was a representation of this Defendant. Note H of the Notes to Financial Statements contained in the October 30, 1969 prospectus is an unaudited note to the extent that it pertains to events occurring after May 31, 1969, except as may be required to fairly present the financial position of Texas International Speedway at May 31, 1969. Further such note recites only that "The Company is of the opinion that the racetrack was in such condition as to satisfy the terms of the option agreement." Finally, the testimony of the Plaintiff's expert witness has been that the disclosure in Note H is a conservative disclosure designed to warn investors of potential dilution and such disclosure is not one which could therefore be material insofar as this Defendant is concerned.

7. This Defendant objects to the reference in Special Issue No. 2 to the October 30, 1969, Registration Statement, for the reasons referred to in paragraph 4 above.

8. This Defendant objects to the submission of the entirety of Special Issue Nos. 3, 4, 5, and 6 for the reason that those special issues inquire as to transactions, acts, practices or courses of business and not to disclosures in the Texas International Speedway prospectus of October 30, 1969. The submission of those issues appears to be predicated on that portion of Section 10(b) of the Securities Exchange Act of 1934 which proscribes "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." This

case falls within the ambit of the holding of the United States Supreme Court in *Santa Fe Industries v. Green,* 430 U.S. 462 (1977). That case dealt with alleged misconduct other than deception contained as a part of materials distributed to the public. The Supreme Court held that the securities laws do not embrace misconduct which is not accomplished through deception in connection with the sale or purchase of securities. In response to the contention that the use of the word "manipulative" in Section 10(b) could be held to prohibit management misconduct which was not of a deceptive character, the court held as follows:

> It is also readily apparent that the conduct alleged in the complaint was not 'manipulative' within the meaning of the statute. Manipulation is 'virtually a term of art when used in connection with securities markets.' *Ernst & Ernst* 425 U.S., at 199. The term refers generally to practices such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity. (omitting citations) Section 10(b)'s general prohibition of practices deemed by the SEC to be 'manipulative' — in this technical sense of artificially affecting market activity in order to mislead investors — is fully consistent with the fundamental purpose of the 1934 Act 'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* . . . . (omitting citations) Indeed, nondisclosure is usually essential to the success of a manipulative scheme. (omitting citation) No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices. But we do not think it would have chosen this 'term of art' if it had meant to bring within the scope of Section 10(b) instances of corporate mismanagement such as

this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.

9. This Defendant further objects to the submission of Special Issue 3(a) because it is duplicative of Special Issue 1(b) and further objects to the submission of Special Issue 3(a) for the same reason as this Defendant objects to the submission of Special Issue 1(b).

10. This Defendant objects to the submission of Special Issue 3(c) for the following reasons:

a. Such issue is multifarious in that it inquires both about a November 12, 1969, sticker to the prospectus and a December 23, 1969, sticker to the prospectus;

b. Such Special Issue deals with a question which is not common to the class, in that a defect with respect to a November 12, 1969, sticker could not serve as a basis for recovery with respect to those persons who purchased securities prior to November 12, 1969, and the December 23, 1969, sticker could not serve as a basis for recovery by those persons who purchased securities prior to December 23, 1969; and

c. There is no evidence as to this Defendant that it participated in any way with regard to the preparation or use of such stickers.

Respectfully submitted,

JACKSON, WALKER, WINSTEAD, CANTWELL & MILLER

/s/ James L. Truitt

James L. Truitt

Attorneys for Defendant Herman & MacLean

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing instrument and the attachment thereto has been served upon the attorneys of record for the plaintiffs in this cause in accordance with the Federal Rules of Civil Procedure on this 3rd day of July, 1979.

/s/ James L. Truitt

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

DAVID M. KEMP, ET AL, Plaintiffs,	)	
VS.	)	Civil Action No. 3-6677-C
LADENBURG, THALMANN & CO., ET AL., Defendants	)	

DEFENDANTS' REQUESTED JURY INSTRUCTIONS AND ISSUES

TO THE HONORABLE WILLIAM M. TAYLOR, UNITED STATES DISTRICT JUDGE:

Defendants attach hereto and submit herewith the instructions which they jointly request be given the jury and the issues which they request be propounded to the jury at the conclusion of trial of this action.

Defendants respectfully reserve the right to supplement and modify this request.

Dated: June 25, 1979

Respectfully submitted,

/s/ James L. Truitt
John L. Lancaster, III
of Jackson, Walker, Winstead,
Cantwell & Miller
4300 First National Bank Building
Dallas, Texas 75202
Attorneys for Defendant
Herman & MacLean

/s/ Stephen Wasinger
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/s/ Patrick F. McGowan
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1200 One Main Place
Dallas, Texas 75250
Attorneys for Defendants
David Witts and Thomas J. Tierney

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing instrument and the attachment thereto has been served upon the attorneys of record for the plaintiffs in this cause in accordance with the Federal Rules of Civil Procedure on this _____ day of June, 1979.

/s/ James L. Truitt

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

DAVID M. KEMP, ET AL, Plaintiffs,	)	
VS.	)	Civil Action No. 3-6677-C
LADENBURG, THALMANN & CO., ET AL., Defendants	)	

CHARGE OF THE COURT AND VERDICT OF THE JURY

MEMBERS OF THE JURY:

Now that you have heard the evidence and the argument, it becomes my duty to give you the instructions of the Court as to the law applicable to this case.

It is your duty as Jurors to follow the law as stated in the instructions of the Court and to apply the rules of law so given to the facts as you find them from the evidence in the case.

You are not to single out one instruction alone as stating the law, but must consider the instructions as a whole.

Neither are you to be concerned with the wisdom of any rule of law stated by the Court. Regardless of any opinion you have as to what the law ought to be, it would be a violation of your sworn duty to base a verdict upon any other view of the law than that given in the instructions of the Court, just as it would be a violation of your sworn duty as judges of the facts to base a verdict upon anything but the evidence in the case.

This case is being submitted to you upon Special Issues propounded to you in the form of questions and your answers to these questions will constitute your findings of fact and your verdict in this case. It is necessary that the Jury be advised of and understand certain legal terms which play such a large part in the determination of this type of litigation, so at the outset I will give you some definitions and explanations.

In a civil action such as this, the burden is upon the party that asserts a particular fact or facts to establish such fact or facts by a preponderance of the evidence and that burden is properly placed in the Special Issues submitted to you.

By the term "preponderance of the evidence" as used in this Charge is meant the greater weight or degree of credible evidence before you.

There are two types of evidence that may be introduced as to the facts of a case. One is direct evidence, such as the testimony of an eyewitness; the other is indirect or circumstantial evidence, the proof of a chain of circumstances pointing to the existence or non-existence of certain facts. A fact is established by circumstantial evidence when the fact sought to be established may be fairly and reasonably inferred from all other facts and circumstances proved in the case. In order to establish a theory, conclusion, or hypothesis by circumstantial evidence, the proven facts and circumstances must be such as to make that theory, conclusion, or hypothesis more reasonably probable, not merely possible, than any other theory, conclusion, or hypothesis based upon those facts and circumstances.

Now, as a general rule, the law makes no distiction between direct and circumstantial evidence, but simply re-

quires that the Jury find the facts in accordance with the preponderance of all of the evidence in the case, both direct and circumstantial.

Rules of evidence ordinarily do not permit witnesses to testify as to opinions or conclusions. An exception to this rule exists as to those whom we call "expert witnesses." Witnesses, who by education and experience have become expert in some art, science, profession or calling, may state an opinion as to relevant and material matter in which they profess to be expert and may also state their reasons for such opinion. It is for you to consider such testimony and give it such weight as you may think it deserves, just as you would evaluate the testimony of any other witness. If you should decide that such opinions are not based upon sufficient education and experience, or if you should conclude that the reasons given in support of such opinions are not sound, or if you feel that they are outweighed by other evidence, you may disregard such opinions entirely.

This is an action arising out of an offering of securities by Texas International Speedway, Inc., (which I will refer to later as "T.I.S.") by means of a prospectus dated October 30, 1969. This prospectus, together with the sticker amendments dated November 12, 1969 and December 23, 1969, is the document in the orange binder which you have been given for your review during the course of this trial. The plaintiffs represent a class of persons who purchased securities of T.I.S. during a period beginning October 30, 1969 and ending January 28, 1970. The plaintiffs contend that T.I.S. sold these securities in violation of Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Action of 1934. Section 17(a) of the Securities Act of 1933 makes it unlawful for any person in connection with the offer or sale of any

securities, by use of the mails or other facilities of interstate commerce in offering or selling securities, direct or indirectly:

(1) to employ any device, scheme, or artifice to defraud; or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Similarly, Rule 10b-5 under the Securities Exchange Act of 1934 provides that it is unlawful for any person, directly or indirectly, in connection with the purchase or sale of any securities, to use any means or instrumentality of interstate commerce or of the mails

(a) to employ any device, scheme or artifice to defraud;

(b) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made not misleading; or

(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person in the connection with the purchase or sale of any security.

The plaintiffs contend that T.I.S. violated the provisions of Section 17(a) and Rule 10b-5 by its use of the prospectus dated October 30, 1969, to sell the securities of-

fered by that prospectus. These securities were $3,300,000 in principal amount of 8% Participating Subordinated Debenture, due October 15, 1984, and 330,000 shares of T.I.S. Common Stock. The plaintiffs contend that the prospectus was false and misleading in that it contained affirmative misrepresentations or that it failed to state certain material facts which were necessary to be stated in order to prevent the statements which were made from being misleading.

For purposes of this charge, you are instructed that the standard of materiality in securities litigation is as follows:

> A misrepresentation or an omitted fact is material if there is a substantial likelihood that a reasonable (investor would consider it important. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.[1]

In the present case, in order for omitted information to be a material fact, it is necessary that such information have been known at the date the prospectus was issued. Thus, in order to find that information omitted from the prospectus was sufficient to render the prospectus false and misleading, you must find both that such information was known on October 30, 1969, by one or more of the persons who prepared the prospectus *and* that such omitted information was material, within the meaning of the definition of materiality stated above.

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[1] *TSC Indusries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), followed in litigation under Rule 10b-5, *Goldberg v. Meridor*, 567 F.2d 209, 218-19 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

T.I.S. was the issuer of the securities sold by means of the prospectus. It is not a party to this proceeding.

(a) The defendants in this proceeding are persons whom the plaintiffs claim to be liable under the federal securities laws because of some relationship which existed between T.I.S. and such defendants at the time of the offering of securities pursuant to the T.I.S. prospectus. These defendants fall into four categories, as follows:

Lawrence H. LoPatin and Leslie Share were executive officers of T.I.S. as well as directors at the time the prospectus was prepared;

(b) Leo B. Margolian, George Kawamoto, David Witts, and Tom J. Tierney were directors of T.I.S. on the date the prospectus was issued, but the evidence indicates clearly that they were not directly involved in the preparation of the prospectus;

(c) Herman & MacLean is a firm of certified public accountants who were the accounting experts for T.I.S. in connection with the preparation of the prospectus;

(d) Spencer J. Buchanan & Associates is an engineering firm which served as the engineering experts for certain work for T.I.S. in connection with the preparation of the prospectus.

As to each of the defendants, the plaintiffs have the burden of proving that such defendant was an aider and abettor and that such defendant acted with a willful intent to deceive or defraud investors in connection with the sale

of T.I.S. securities. A person may be held to be an aider and abettor only if he has knowledge of the primary party's fraud *and* if he knowingly renders a substantial contribution to that activity.[2]

In order for any of the defendants to be found liable, it is necessary that the plaintiff establish by a preponderance of the evidence that such defendant acted with *scienter.* Scienter is defined in the law as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 194 fn. 12 (1976). Reckless conduct may constitute scienter if it is so extreme as to be tantamount to willful intent to deceive, manipulate or defraud. To be equivalent to such willful intent, recklessness must be conduct which is "highly unreasonable, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the defendant must have been aware of it."[3] Negligence – whether gross, grave or inexcusable – cannot serve as a substitute for scienter.[4]

If you find that the defendants had an honest belief that the statements in the prospectus for which they were responsible were true, whether or not that belief was reasonably based, you must find for the defendants.[5]

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[2] *Woodard v. Metro Bank of Dallas,* 522 F.2d 84, 97 (5th Cir. 1975); *Rolf v. Blyth, Eastman Dillon & Co., Inc.,* 570 F.2d 38, 47 (2d Cir. 1978).

[3] *Sundstrand Corp. v. Sun Chemical Corp.,* 553 F.2d 6033 (7th Cir.) *cert. denied,* 434 U.S. 1314 (1977).

[4] *MacLean v. Alexander,* slip opinion, dated May 18, 1979, pp. 12-13 (3rd Cir. 1979), *reversing* 420 F.Supp. 1057 (D.C. Del., 1976).

[5] *O'Connor v. Ludlum,* 92 F.2d 50, 54 (2d Cir. 1937); *MacLean v. Alexander,* slip opinion, *supra.*

Bearing in mind the foregoing definitions and instructions, and such further instructions as will hereinafter appear, you will answer the following Special issues:

Special Issue No. 1

Do you find from a preponderance of the evidence that the T.I.S. prospectus dated October 30, 1969, was materially false and misleading?

Answer "It was materially false and misleading" or "it was not materially false and misleading."

ANSWER: _____.

If you have answered Special Issue No. 1 by saying "it was materially false and misleading," you shall answer Special Issue No. 2.

If you have answered Special Issue No. 1 by saying "it was not materially false and misleading," you need not answer Special Issue No. 2 or any of the remaining Special Issues.

Special Issue No. 2

Do you find from a preponderance of the evidence that the plaintiffs relied upon those matters in the T.I.S. prospectus which were false and misleading in purchasing T.I.S. securities?

Answer "They did rely" or "They did not rely."

ANSWER: _____.

If you have answered Special Issue No. 2 "they did rely," you shall answer Special Issue No. 3. Otherwise, you need not answer Special Issue No. 3 or any of the remaining Special Issues.

Special Issue No. 3

Do you find from a preponderance of the evidence that the economic losses suffered by the plaintiffs were caused[6] by the matters in the T.I.S. prospectus which were false and misleading?

Answer "The damages were so caused" or "The damages were not so caused."

ANSWER: _____.

If you have answered Special Issue No. 3 by saying "the damages were so caused," you shall answer Special Issue No. 4. Otherwise you need not answer Special Issue No. 4 or any remaining Special Issues.

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[6]*St. Louis Union Trust Co. v. Merril, Lynch, Pierce, Fenner & Smith*, 56 F.2d 1040, 1048 (8th Cir. 1977) *cert. denied*, 435 U.S. 925 (1978):

> In order to prevail in an action for securities fraud under Section 10(b) and Rule 10b-5, a plaintiff must show some causal nexus between the defendant's wrongful conduct and his (the plaintiff's) loss. This requirement preserves the basic concept that causation must be proved else defendants could be held liable to all the world.

See also *Herpich v. Wallace*, 430 F.2d 792, 810 (5th Cir. 1970):

> The gist of the Rule 10b-5 action for damages is economic injury to the plaintiff resulting proximately from the acts of the defendants which constitute a violation of the rule.

Special Issue No. 4

Do you find from a preponderance of the evidence that, as to each of the persons named below, such person was an aider and abettor, as that term has been defined for you in the instructions of the Court.

Answer, as to each such person, that he or it "was an aider or abettor" or "was not an aider and abettor."

ANSWER:

(a) Lawrence H. LoPatin: _____.

(b) Leslie Share: _____.

(c) Leo B. Margolian: _____.

(d) David Witts: _____.

(e) Tom J. Tierney: _____.

(f) George Kawamoto: _____.

(g) Herman & MacLean: _____.

(h) Spencer J. Buchanan & Associates: _____.

If you have answered Special Issue No. 4 as to any defendant by saying as to such defendant that he "was an aider and abettor," then you shall answer this Special Issue No. 5. Otherwise, you shall not.

Special Issue No. 5

Do you find from a preponderance of the evidence that, as to each of the persons named below, such person acted with scienter, as that term has been defined for you in the instructions of the Court.

Answer, as to each such person, that he or it "acted with scienter" or "did not act with scienter."

ANSWER:

(a) Lawrence H. LoPatin: _____.

(b) Leslie Share: _____.

(c) Leo B. Margolian: _____.

(d) David Witts: _____.

(e) Tom J. Tierney: _____.

(f) George Kawamoto: _____.

(g) Herman & MacLean: _____.

(h) Spencer J. Buchanan & Associates: _____.

DEFENDANT H&M'S MOTION FOR DIRECTED VERDICT
(Filed 7/3/79)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

DAVID M. KEMP, ET AL, Plaintiffs,	)	
vs.	)	Civil Action No. CA 3-6677-C
LADENBURG, THALMANN CO., ET AL., Defendants	)	

DEFENDANTS HERMAN & MACLEAN AND M. RICHARD HERMAN MOTION FOR DIRECTED VERDICT

COMES NOW HERMAN & MacLEAN and M. RICHARD HERMAN, Defendants, pursuant to Rule 50(a) of Federal Rules of Civil Procedure, and at the close of all the evidence, and renew their Motion for Directed Verdict filed at the close of Plaintiff's evidence and for cause would show the court the following:

I.

There is no evidence that these Defendants made a false or misleading representation in the Texas International Speedway October, 1969 Prospectus.

II.

There is no evidence that these Defendants knew in October of 1969 that the amounts of estimated costs set forth in the Use of Proceeds Section of the Texas International Speedway October, 1969 Prospectus were not accurate.

III.

There is no evidence that these Defendants made false or misleading representations in the Texas International Speedway October, 1969 Prospectus within intent to deceive, manipulate or defraud, or with the legal equivalent of such intent.

IV.

There is no evidence that these Defendants had knowledge of fraudulent activities, if any, committed by any other Defendants in connection with the Texas International Speedways Securities Issue.

V.

There is no evidence that these Defendants at any time gave substantial assistance, with the intent to deceive, manipulate or defraud the Plaintiff class, to fraudulent activities, if any, committed by other Defendants.

VI.

There is no evidence that these Defendants joined in a conspirary to defraud members of the Plaintiff class.

VII.

There is no evidence that these Defendants at any time committed overt acts, with the intent to deceive, manipulate or defraud the Plaintiff class, as part of a conspiracy, if any, to defraud involving other Defendants.

VIII.

There is no evidence that these Defendants were sellers of a security within the meaning of the Texas Securities Act of 1957.

Inasmuch as one or more of the foregoing elements is essential for the maintenance of the Plaintiff's claims against these Defendants, the Court should properly withdraw this case from the jury and enter judgment that Plaintiffs take nothing against them.

WHEREFORE, PREMISES CONSIDERED, DEFENDANTS Herman & McLean and M. Richard Herman pray that the foregoing Motion for Directed Verdict be granted, and that these Defendants be dismissed from this action with prejudice to the rights of the Plaintiff class to reassert said claims, and that these Defendants recover their costs expended herein.

Respectfully submitted,

JACKSON, WALKER, WINSTEAD,
CANTWELL & MILLER
4300 First National Bank Bldg.
Dallas, Texas 75202
214/655-2911

By: /s/ JOHN L. LANCASTER, III

Attorneys for Defendants
Herman & MacLean and
M. Richard Herman

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Defendants' Motion for Directed Verdict has been hand delivered on this ____ day of July, 1979 to all counsel of record.

/s/ JOHN L. LANCASTER, III.

TRANSCRIPT OF EXCERPTS OF CHARGE OF THE COURT AND VERDICT AS GIVEN BY THE TRIAL COURT ON THE RECORD TO THE JURY, (Dated 7/3/79)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR., Individually and as Designated Class Representatives,
Plaintiffs,

vs.

HERMAN & MacLEAN, Certified Public Accountants, a Partnerhsip, SPENCER J. BUCHANAN & ASSOCIATES, Inc., a Corporation, LAWRENCE A. LoPATIN, LESLIE SHARE, GEORGE E. KAWAMOTO and LEO B. MARGOLIAN,
Defendants

CHARGE OF THE COURT AND VERDICT JULY 3, 1979

THE COURT: Ladies and gentlemen of the jury, I will read to you the Charge of the Court and Verdict. I am not going to read the verdict but I will read the issues by which you will render your verdict.

As I told you in the beginning, nothing that I say and/or do is in any way intended to affect your judgment on the facts. You are the sole and exclusive judges of the facts.

This Charge is addressed to you as members of the jury and, incidentally, it will go into the jury room with you.

Now that you have heard the evidence and the arguments, it becomes my duty to give you the instructions of the Court as to the law applicable to this case.

It is your duty as jurors to follow the law as stated in the instructions of the Court, and to apply the rules of law so given to the facts as you find them from the evidence in this case.

You are not to single out one instruction alone as stating the law, but must consider the instructions as a whole.

Neither are you to be concerned with the wisdom of any rule of law stated by the Court. Regardless of any opinion you may have as to what the law ought to be, it would be a violation of your sworn duty to base a verdict upon any view of the law other than that given in the instructions of the Court; just as it would be a violation of your sworn duty, as judges of the facts, to base a verdict upon anything but the evidence in the case.

This case is submitted to you on special issues, propounded to you in the form of questions, which you will answer from a preponderance of the evidence submitted to you under the rulings of the Court, answering the questions by unanimous consent of the jury through your foreman and writing your answers in the space provided therefor following each question. It is necessary that the jury be advised of, and understand, certain legal terms which play such a large part in the determination of this

sort of litigation, so at the outset, I will give you some definitions and explanations.

In a civil action such as this the burden is on the Plaintiffs to prove their allegations against the Defendants by a preponderance of the evidence.

By the term "preponderance of the evidence," as used in this Charge, is meant the greater weight and degree of credible evidence.

There are two types of evidence that may be introduced as to the facts of a case. One is direct evidence, such as the testimony of any participant in the transactions which led up to the filing of the Registration Statement and the distribution of the Prospectus of Texas International Speedway, Inc. dated October 30, 1969, and during the ninety (90) day period following.

The other type of evidence is indirect evidence or circumstantial evidence. A fact is established by circumstantial evidence when the fact sought to be established may be fairly and reasonably inferred from all other facts and circumstances proved in the case. In order to establish a theory, conclusion or hypothesis by circumstantial evidence, the proved facts and circumstances must be such as to make that theory, conclusion or hypothesis more probable, not merely possible, than any other theory, conclusion or hypothesis based upon those facts and circumstances. In other words, the fact to be proved is established as an inference from proven circumstances.

As a general rule, the law makes no distinction between direct and circumstantial evidence, but simply requires that the jury finds the facts in accordance with the preponderance of all of the evidence in the case, both direct and circumstantial.

During the trial of this case, certain testimony has been read to you from depositions, consisting of sworn answers to questions asked of the witness in advance of the trial by one or more of the parties. The testimony of a party whether present or absent in court, or a witness who cannot be present, may be presented under oath in the form of a deposition.

The rules of evidence ordinarily do not permit witnesses to testify to opinions or conclusions. An exception to this rule exists as to those whom we call "expert witnesses." These are witnesses who, by education and experience, have become expert in some art, science, profession or calling. Such witnesses may state their opinions as to relevant and material matters, in which they profess to be an expert, and may also state their reasons for the opinion.

You have heard testimony of expert witnesses in this case. It is for you to consider such testimony and give it such weight as you may think it deserves. If you should decide that such opinions are not based upon sufficient education and experience, or if you should conclude that the reasons given in support of such opinions are not sound, or if you feel that they are outweighed by other evidence, you may disregard such opinions entirely.

DESCRIPTION OF THE CASE

This case has been designated as a class action. The Plaintiffs who have testified at trial, namely, Ralph E. Huddleston ("Huddleston") and Chester E. Bradley, Jr. ("Bradley") are representatives of a designated class of persons who purchased common stock and debentures of Texas International Speedway, Inc. ("TIS") during the period of October 30, 1969 through January 28, 1970 and claim to have suffered damages as a result of such purchases.

TIS was the issuer of securities purchased by the Plaintiffs. It is not a party to this proceeding. The Defendants remaining in this class action are Lawrence A. LoPatin, hereinafter called "LoPatin," Leslie Share, hereinafter called "Share," Leo B. Margolian, hereinafter called "Margolian," George E. Kawamoto, hereinafter called "Kawamoto," Herman & MacLean, Certified Public Accountants, hereinafter called "H & M," and Spencer J. Buchanan & Associates, Inc., hereinafter called "Buchanan."

In summary form, the allegations of the Plaintiffs are that all of some of the Defendants, directly or indirectly, committed a civil fraud by omitting in the Registration Statement and Prospectus of TIS made effective as of October 30, 1969, and supplemented on November 12, 1969, and December 23, 1969, material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading. In addition, it is alleged that the Defendants, directly or indirectly, engaged in and did not disclose in the October 30, 1969 Registration Statement and Prospectus transactions acts, practices or courses of conduct which operated as a fraud upon Plaintiffs.

I further charge you that for the purposes of this class action, the October 30, 1969, Registration Statement includes the exhibits and the Prospectus dated October 30, 1969, which has been admitted into evidence. For ease of reference, I will hereinafter refer to this group of documents as the Registration Statement.

Also, for ease of reference, I will hereinafer refer to the TIS automotive racing facility as the "Texas Speedway."

Incidentally I say this to you though what I am saying won't be in the Charge, but this action is being tried on the

issue of liability of the Defendants only. Depending on the verdict rendered by you as triers of the fact the Court will mold the verdict so as to determine the damages, if any, suffered by Plaintiffs, Huddleston, Bradley and the designated class.

The provisions of the relevant federal securities laws at issue in this class action are contained in the Securities Act of 1933 (the "1933 Act"), the Securities Exchange Act of 1934 (the "1934 Act"), and Rule 10b-5 of the Securities and Exchange Commission ("S.E.C.").

1. The relevant section of the 1934 Act is contained in Section 10(b) and Rule 10b-5, the rule promulgated by the SEC under Section 10(b). Section 10(b) states as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention or such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

The provisions of Rule 10b-5, as promulgated by the S.E.C. under the authority of Section 10(b), state that:

It is unlawful to do any of the following things, directly or indirectly, in connection with the purchase or sale of any security:

"(a) to employ any device, scheme or artifice to defraud;

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of circumstances under which they are made, not misleading, or

(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person."

2. Plaintiffs also contend that each of the remaining Defendants violated applicable sections of the Texas Securities Act of 1957. This statute, commonly known as the Texas Blue Sky Law, during the period October 30, 1969, through January 28, 1970, contained the following relevant statutory provions:

"DEFINITIONS"

B. The terms 'person' and 'company' shall include a corporation, person, joint stock company, partnership, limited partnership, association, company, firm, syndicate trust, incorporated or unincorporated, heretofore or hereafter formed under the laws of this or any other state, country, sovereignty or political subdivision thereof. . . .

E. . . . The term 'sale' means and includes contracts and agreements whereby securities are sold, traded or exchanged for money, property or other things of value, or any transfer or agreement to transfer in trust or otherwise. . . The term "sell" means any act by which a sale is made, and the term 'sale' or 'offer for sale' shall include a subscription . . . a solicitation of sale . . . by a circular letter, or advertisement or otherwise, including the deposit in a United States Post Office or mail box or in any manner in the United States mails within this state of a letter, circular or other advertising matter. . .

F. The terms 'fraud' or 'fraudulent practice' shall include any misrepresentations, in any manner, of a relevant fact; any promise or representation or prediction as to the future not made honestly and in good faith, or an intentional failure to disclose a material fact . . ."

The main provision is Section 33 which states:

"Any person who . . . offers or sells a security. . . by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading (when the person buying the security does not know of the untruth or omission, and who in the exercise of reasonable care could not have known of the untruth or omission) is liable to the person buying the security from him . . ."

In regard to Special Issues submitted to you after the following definitions, you are instructed that under the Texas Blue Sky Law a person is a seller of a security if he forms any link in the chain of the selling process or if he performs any act by which a sale is made.

DEFINITIONS OF TERMS AND EXPRESSIONS

In your consideration of whether the Defendants or any of them violated Section 10(b) of the 1934 Act, SEC Rule 10b-5 or the Texas Securities Act of 1957 as amended, you are required to keep in mind the definitions of certain terms and expressions which are used in the context of the federal and state securities laws;

1. In connection with the term "material fact," you are instructed that a fact is material if there is a substantial likelihood that a reasonable investor would consider the omitted facts or misstatements important in deciding whether to invest.

2. In connection with the expression "omission to state a material fact," you are instructed that such an omission may be made in violation of the federal and/or Texas securities laws if it is material and needs to be disclosed in order to make the statements made in a registration statement not misleading, in the light of the circumstances existing at the time the statement was made. A statement or omission may not be held false or misleading merely because subsequent events prove it to have been erroneous.

3. You are further instructed that the term "fraud" as applied to violations of federal and/or Texas securities laws includes any act or omission of a person which deceives another person, whether it is only a single act, or a combination of circumstances, or acts or words which amount to a suppression of the truth, or whether it is merely intentional silence.

4. In connection with the term "intentionally" or the expression "with intent to deceive or defraud" you are instructed it means acting with a mental state embracing intent to deceive, manipulate or defraud.

5. In connection with the term "recklessly" or the expression "with reckless disregard for the truth" you are instructed that these terms refer to conduct which is so extreme as to be a form of intentional conduct or behavior equivalent to an intent to deceive, manipulate or defraud. To be equivalent to such intent, recklessness must be conduct which is highly unreasonable, involving not merely simple or even inexcusable negligence but extreme departure from the standards of ordinary care and which presents a danger of misleading buyers or sellers that is either known to the Defendant or is so obvious that the Defendant must have been aware of it.

6. In connection with the term "aided and abetted" you are instructed that it means conduct whereby a person gives substantial assistance, support or encouragement to the unlawful conduct of others with knowledge of the alleged fraud or "recklessly" as defined for you previously.

7. In connection with the term "controlling person" you are instructed it refers to a person who possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of another person or corporation.

Bearing in mind the foregoing definitions and instructions and such further instructions as will appear hereafter, you will answer the following Special Issues:

SPECIAL ISSUE NO. 1:

Do you find from a preponderance of the evidence that the TIS Prospectus dated October 30, 1969 was materially misleading as to any one or more of the following:

Answer "Yes" or "No" as to each.

(a) The cost of purchasing land for and completing the facilities of the Texas Speedway identified in the Use of Proceeds section and to place those facilities in operation.

Then there is a blank line for your answer.

(b) The working capital position of TIS on October 30, 1969, with a blank line for your answer.

(c) The description of any obligation of American Raceways, Inc. to TIS, with a blank line for your answer.

(d) The fulfillment of the conditions of the option to purchase shares of TIS stock by the Holloway Sand & Gravel Company with a blank line for your answer.

If you have answered "Yes" as to any question of Special Issue No. 1, you will answer the following Special Issue.

SPECIAL ISSUE NO. 2:

Do you find from a preponderance of the evidence that in connection with the sale of the securities of TIS to Plaintiffs during the period October 30, 1969, through January 28, 1970, any of the Defendants with reckless disregard for the truth failed to disclose in the October 30, 1969 Registration Statement any one or more of the matters to which you have answered "Yes" in Special Issue No. 1, if any?

Answer "Yes" or "No" as to each Defendant listed below as to each matter to which you have answered "Yes" in answer to Special Issue No. 1, if any

Then there are lines for your answers to Sections (a), (b), (c) and (d) of Special Issue No. 1 with a column for LoPatin, Share, Kawamoto, Margolian, H&M and Buchanan.

SPECIAL ISSUE NO. 3:

Do you find from a preponderance of the evidence that in connection with the sale of securities of TIS to Plaintiffs during the period October 30, 1969 through January 28, 1970, Defendant LoPatin and/or Share engaged in one or more of the following transactions, acts, practices or courses of business?

Answer "Yes" or "No" as to each.

(a) Caused the pro forma transactions that are part of the May 31, 1969, pro forma balance sheet in the October

30, 1969, Registration Statement to show that TIS would have $93,870.00 of cash available for general corporate purposes after an allowance of $295,771.00 for funds to be used for general administrative expenses to the opening date of the Texas Speedway, with a blank line for your answer.

(b) Caused Defendant Buchanan to execute a consent dated October 24, 1969, to allow its name to be used as an expert in the penultimate paragraph under the Use of Proceeds section and the fourth paragraph of the Plant and Property sections without requiring Buchanan to perform due diligence procedures to ascertain the accuracy of the cost estimates set forth therein, with a blank line for your answer.

(c) Caused two supplements to the October 30, 1969 Registration Statement to be filed with the SEC and stickered on the Prospectus, said supplements being dated November 12, 1969, and December 23, 1969, and stating certain information about the races run at the Texas Speedway on November 9, 1969, and December 7, 1969, without also stating in the supplements that the races had resulted in substantial losses to TIS due to lack of attendance and/or adverse weather conditions, with a blank line for your answer.

(d) Caused TIS on October 21, 1969, to borrow $100,000.00 from Holloway Construction Company without disclosing in the October 30, 1969, Registration Statement that such borrowings had been obtained from a company affiliated with the principal contractor for the Texas Speedway, with a blank line for your answer.

(e) Caused TIS during the period October 30, 1969, to January 23, 1970, to advance to American Raceways, Inc., funds in excess of $250,000.00 from the proceeds of

the public offering instead of using those funds to pay outstanding construction costs of the Texas Speedway, administration costs to place the Texas Speedway in operation and expenses of the public offering, with a blank line for your answer.

If you have answered any section of the preceding Special Issue "Yes," then you will answer the following Special Issue.

SPECIAL ISSUE NO. 4:

Do you find from a preponderance of the evidence that as to any transaction, acts, practices or course of business to which you have answered "Yes" in Special Issue No. 3, if any, that said transactions, acts, practices or course of business were material facts as that term has been defined?

Answer "Yes" or "No" as to each section to which you have answered 'Yes" in Special Issue No. 3, if any. Then there is a blank line for (a), (b), (c), (d) and (e).

If you have answered any section of the preceding Special Issue "Yes," then you will answer the following Special Issue.

SPECIAL ISSUE NO. 5:

Do you find from a preponderance of the evidence that as to any transactions, acts, practices or course of business which you have found to be "material facts," if any, in answer to Special Issue No. 4, that said transactions, acts, practices or course of business were engaged in by the Defendant LoPatin and/or the Defendant Share with intent to deceive or defraud?

Answer "Yes" or "No" as to each Defendant and as to each section to which you have answered "Yes" in Special

Issue No. 4, if any. Then there is a blank line for (a), (b), (c), (d) and (e) with columns for LoPatin and Share.

If you have answered "Yes" as to any one of more of the Sections of Special Issue No. 5, then answer the following Special Issue:

SPECIAL ISSUE NO. 6:

Do you find from a preponderance of the evidence that one or more of the following Defendants aided and abetted the unlawful conduct of the Defendants LoPatin and/or Share, if any, in causing the transactions, actions, practices and course of conduct to occur which operated as a fraud or deceit upon the Plaintiffs?

Answer "Yes" or "No" as to each of the following listed Defendants. Then there is a blank line for each of the Defendants' names, Kawamoto, Margolian, H&M and Buchanan.

SPECIAL ISSUE NO. 7:

Do you find from a preponderance of the evidence that one or more of the following Defendants constituted a seller under the Texas Securities Act as that term has been defined to you with respect to the securities of TIS during the period October 30, 1969 through January 28, 1970?

Answer "Yes" or "No" as to each of the Defendants. There is a blank line for LoPatin, Share, Kawamoto, Margolian, H & M and Buchanan.

SPECIAL ISSUE NO. 8

Do you find from a preponderance of the evidence that one or more of the following Defendants, directors and officers of American Raceways, Inc. was a "controlling person" of TIS as that term has been defined?

Answer "Yes" or "No" as to each listed Defendant. Then there is a blank line for LoPatin, Share and Kawamoto.

You are the sole judges of the facts, of the credibility of the witnesses and of the weight and credit to be given to the testimony, but the law you are bound to receive from the Court as it is given you herein, and be governed thereby.

You are instructed further that while you are deliberating upon the answers to the Special Issues that have been submitted to you, you will not mention or refer to, nor take into consideration any matter, fact or circumstance, other than the testimony that has been admitted before you, all of which I instruct you particularly to observe and obey.

You are instructed further that each Special Issue answered must be answered by a unanimous vote of the Jury.

In arriving at your Verdict, you are instructed not to let bias, prejudice, sympathy or any such emotion play any part in your deliberation.

You will now retire to the Jury Room, select your own Foreman and write your answers to the Special Issues in the blank space left after each Special Issue for that purpose. Your Foreman will sign the form of Verdict as it is shown below and that is signed by me as the Judge.

The Verdict reads: We, the Jury, have answered the foregoing Special Issues as indicated above and herewith return the same into Court as our Verdict in this case. There is a date line and a line for the signature of the Foreman.

EXHIBIT Px-1 – EXCERPT FROM TIS REGISTRATION STATEMENT FILED WITH THE SEC ON 10/30/69

TIS Prospectus Dated 10/30/69 Together With Supplements Dated 11/21/69 and 12/23/69

PROSPECTUS

3,300 Units

TEXAS INTERNATIONAL SPEEDWAY, INC.

(A Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

$3,300,000 8% Participating Subordinated Debentures due October 15, 1984

330,000 Shares of Common Stock ($1.00 par value)

Offered only in Units of $1,333 consisting of $1,000 principal amount of Debentures and 100 shares of Common Stock at $3.33 per share. The Debentures will bear interest payable quarterly from October 15, 1969 but no interest payment will be made thereon until April 15, 1970. (See captions "Introductory Statement" and "Description of Debentures" herein for certain terms of the Debentures.) The Debentures and Common Stock will be immediately separately transferable.

THESE SECURITIES INVOLVE A HIGH DEGREE OF RISK

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public (1)	Cash Underwriting Discounts, Commissions and Expenses (2)	Proceeds to the Company (3)
Per Unit	$1,333.00	$127.55	$1,205.45
Total	$4,398,900.00	$420,915.00	$3,977,985.00

(1) Plus accrued interest on the Debentures from October 15, 1969.

(2) Includes $395,915 (119.97 per Unit) cash discount and $25,000 ($7.58 per Unit) cash for non-accountable expenses of the underwriters. The Company has agreed to issue to Ladenburg, Thalmann & Co. (the "Representative"), in its individual capacity, a warrant to purchase 23,000 shares of Common Stock for five years at a price of $4.00 per share. The warrant is transferable only among the partners and employees of the Representative. In addition, Graham Loving & Co., a proposed Selected Dealer in this offering (see caption "Underwriting" herein), has purchased 10,000 shares of Common Stock at a price of $3.00 per share. These shares, and the shares issuable upon exercise of such warrant, are included in the Registration Statement. Prior to any public offering of any such shares, the Company will file a Post-effective Amendment indicating the terms of such offering. Any profits realized on the sale of such shares purchased by Graham Loving & Co. and any profits realized upon exercise of such warrant may be deemed additional underwriting compensation. The Representative will pay, out of its fee for managing this offering, $44,000 to Graham Loving & Co. as a finder's fee. The Company has also agreed to indemnify the underwriters against certain liabilities under the Securities Act of 1933. (See caption "Underwriting" herein.)

(3) Before deduction of expenses of the Company in connection with this offering for such items as legal and

accounting fees, printing expense and filing fees and for $11,000 paid in reimbursement of expenses and counsel fees to the aforementioned Graham Loving & Co. (See caption "Underwriting" herein.) The total expenses are estimated at $140,000 ($42.42 per Unit).

The offering price to the public has been arbitrarily determined by the Company without reference to book value or the Company's financial condition. The portion of the net proceeds of the securities offered hereby which the Company has allocated to the Common Stock will be approximately the same price per share as the Company received for the presently outstanding shares of Common Stock. See caption "Organizational Transactions" herein. The Company has not as yet commenced business. There is no market for these securities and no assurance can be given that a market will arise as a result of this offering. Attention is directed to the caption "Introductory Statement" herein for a discussion of certain risk features that affect these securities.

LADENBURG, THALMANN & CO.

The date of this Prospectus is October 30, 1969.

The Units are offered subject to prior sale, to allotment, and to withdrawal, cancellation or modification of the offer without notice and when, as and if issued by the Company and accepted by the Underwriters and subject to the approval of certain legal matters by counsel for the Company and counsel for the Underwriters. It is expected that delivery of the units to the Underwriters will be made on or about November 7, 1969.

Until January 28, 1970 (90 days from the date of this Prospectus) all dealers effecting transactions in the

registered securities, whether or not participating in this distribution, may be required to deliver a Prospectus. This is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

No dealer, salesman or other person has been authorized to give any information or to make any representation not contained in this Prospectus in connection with the offer made by this Prospectus and, if given or made, such information or representation must not be relied upon as having been authorized by the Company or by any Underwriter. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, the securities offered hereby in any state to any person to whom it is unlawful to make such offer in such state. Neither delivery of this Prospectus nor any sale hereunder shall under any circumstances create an implication that there has been no change in the affairs of the Company since the date hereof.

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABLILIZE OR MAINTAIN THE MARKET PRICES OF THE DEBENTURES AND/OR COMMON STOCK OF THE COMPANY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABLIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

INTRODUCTORY STATEMENT

The purpose of this offering is to provide capital to finance the construction and placing in operation of an automobile racing facility in the area of Bryan-College Station, Texas by a new company incorporated in January, 1969. (See caption "Use of Proceeds" herein.) Attention is directed to certain speculative aspects of this offering.

1. The Debentures offered hereby will be unsecured and subordinated in right of payment to Senior Indebtedness, as defined in the Indenture. As of the commencement of operations, it is anticipated that the Company will have no Senior Indebtedness, but the Debentures contain no restrictions on the creation by the Company of Senior Indebtedness, secured or unsecured. The Debentures are redeemable by the Company at any time after October 31, 1971, without premium, except that upon redemption of the Debentures, whether at or prior to maturity, they are entitled to receive an Income Participation Premium equal to 1% of the Company's aggregate net income, after taxes, for all fiscal years ending prior to redemption for each $100,000 of Debentures outstanding. Net income for this purpose means the aggregate consolidated net income of the Company and its subsidiaries for the entire period since the issuance of the Debentures, after deducting any losses in any of the fiscal years, as determined by the Company's independent certified public accountants and reported to the shareholders in the annual reports of the Company. Based upon the total amount of Debentures being offered, this Income Participation Premium will amount initially to 33% of any such net income. It should be noted that no Income Participation Premium will be received for all or any part of the fiscal year during which Debentures are redeemed, whether such redemption is

made through operation of the sinking fund or otherwise. This period could be as long as 12 months. If, as is contemplated the Company's fiscal year will end on November 30 each year, there will be 10½ months of earnings or losses prior to the sinking fund payment date of October 15 which will not be included in the computation of Income Participation Premium in making such payment and, similarly, in the event of a redemption on a November 30, there will be 12 months of earnings or losses not included in such computation. (See sub-caption "Redemption and Sinking Fund Provisions" under caption "Description of Debentures" herein.) The Debentures will bear interest from October 15, 1969, payable quarterly, but no interest payment will be made thereon until April 15, 1970. The Debentures are entitled to a sinking fund payment, in cash or by delivery of Debentures purchased by the Company or redeemed, of $275,000 per year on October 15 in each year commencing with the year 1973 and ending with the year 1983. In the event of default in payment of two successive interest payments or any principal or Income Participation Premium payment the Debentures will have voting rights as described under the subcaption "Voting Rights" under the caption "Description of Debentures" herein until all defaults are cured. The voting rights of the Debentures in such event would amount to an aggregate of 66,000 votes, which would not be sufficient to pass or defeat any proposed corporate action or to elect a director to the Board of Directors of the Company as presently constituted. American Raceways Inc. has deposited in escrow with National Bank of Commerce of Dallas (of Dallas, Texas), the Trustee under the Indenture pursuant to which the Debentures will be issued, a sum equal to one year's interest on the Debentures ($264,000) to be used to pay interest on the Debentures in the event that the Company shall fail to make any interest payment

during the period the escrow is in effect. The escrow will remain in effect until the Company shall have earnings, as defined in the escrow agreement, for a full fiscal year equal to one year's interest on the Debentures then outstanding. However, there is no assurance that the Company will ever have sufficient earnings to pay the interest on the Debentures or that the sum deposited will be sufficient to pay all of the defaults, if any, in payment of interest by the Company. American Raceways Inc. is not obligated to deposit or pay any amount in excess of the $264,000 deposited. Said funds may not be used to pay any default which might occur in principal or Income Participation Premium or sinking fund payment or any other default, and said escrow could be terminated and the deposit refunded to American Raceways Inc. upon the earnings requirement described above being satisfied, notwithstanding that a default in interest, principal or Income Participation Premium payments or any other default might exist. (See sub-caption "Deposit of Funds to Pay Interest" under caption "Description of Debentures" herein.)

2. For Federal income tax purposes the Debentures may be deemed to contain "original issue discount". In such event, all or part of any gain realized upon any sale of the Debentures may be taxable as ordinary income rather than as capital gain. (See sub-caption "Original Issue Discount" under caption "Description of Debentures" herein.)

3. The price fixed for sale of the securities offered hereby has been arbitrarily determined by the Board of Directors of the Company and does not necessarily bear any relationship to the value of the securities offered hereby. The portion of the net proceeds of the securities offered hereby which the Company has allocated to the Common Stock will be approximately the same price per share as the Company received for the presently outstand-

ing shares of Common Stock. The present holders of Common Stock were able to purchase solely an equity investment whereas the purchasers in this offering must invest $3.00 in the Company's debt securities for each dollar they invest in the Company's equity securities. It must be anticipated that at the present time the Company could not otherwise sell its debt securities except at a much higher, and perhaps prohibitive, interest rate. No market presently exists for any of the Company's securities, and unless a market is established for the securities offered hereby the purchasers thereof may be unable to sell them.

4. The Company has not yet commenced operations and accordingly is subject to all of the risks to which a new enterprise is exposed, such as the possibility that the Company may have overestimated the patronage and revenues which its facility will receive or underestimated its operating or construction costs, which could result in losses to the Company and its investors and the inability of the Company to meet its obligations. There is no assurance that the Company will ever be able to operate profitably or that dividends on the shares of Common Stock will be paid in the future. The Indenture under which the Debentures are issued prohibits the payment of dividends, other than dividends payable in capital stock. (See sub-caption "Restrictions on Dividends and Acquisition of Stock" under caption "Description of Debentures" herein.) The Company has had no revenues to date.

5. The Company is in the process of constructing an automobile racing facility in the area of Bryan-College Station, Texas (see Map, page 15), consisting of a speedway track and a road track. (See caption "Plant and Property" herein.) The road track is for all practical purposes completed and the speedway track and other facilities are substantially completed. The Company knows of no com-

parable installation in that area and accordingly the patronage which such facility may receive and the revenues that will be derived therefrom cannot be predicted. The Company will have no revenues until the commencement of operations and, although it has made provision for contingencies in estimating the amount of funds necessary for the project, in the event that adverse weather conditions, strikes or other unforeseen delays in completion of construction of the speedway track and other facilities should occur, such delays would adversely affect the Company's ability to meet its fixed obligtions. A similar situation might be encountered if the estimated cost of the facility should be exceeded. Of the total construction, preparation, promotional and administrative costs which are estimated by the Company to be $6,249,338, on September 15, 1969 approximately $1,340,560 (21%) was not based on firm contracts but on estimates by the Company or its engineers. (See captions "Use of Proceeds" and "Plant and Property" herein.)

6. As set forth herein, the Company has obtained a sanction from the Sports Car Club of America, Incorporated (SCCA) to hold a Canadian-American Challenge Cup Race on its road track on November 9, 1969. In addition, the Company has entered into a contract with the National Association for Stock Car Racing, Inc. (NASCAR) to hold a Grand National Stock Car Race on its speedway track on December 7, 1969 and to hold Grand National Stock Car Races in June and December each year from June, 1970 through June, 1979. The sanction for the race scheduled to be held on December 7, 1969 has not yet been issued, and NASCAR has temporarily dropped the proposed race from its schedule pending an agreement as to the amount of prize money to be paid by the Company for this race. In the event that agreement on

the prize money is not reached prior to December 7, 1969, no sanction will be issued by NASCAR and the proposed race will not be run. If this should occur, or if the Company's speedway track is not completed by December 7, 1969, the Company will lose the revenues to be derived from the race scheduled for that date and, unless it obtains sanctions for a race from another sanctioning body, it will have no further revenues until June, 1970. Such a situation would adversely affect the Company's ability to meet its fixed obligations, including interest on the Debentures offered hereby. (See caption "Options and Warrants" herein as to the option to be received by the principal contractor if the tracks are finished on schedule.) Such sanctions merely authorize the holding of a race in which licensed drivers of the sanctioning body may compete but do not ensure the participation of any specific drivers or cars for any specific race. (See sub-captions "Sanctions" and "Prizes" under caption "History and Business" herein.)

7. After the completion of this offering, the present stockholders, who consist primarily of American Raceways Inc. and affiliates thereof or of the Company, will have invested $1,300,500 or 54% of the equity capital received by the Company in return for which they will have received 57% of the equity interest in the Company and will have 57% of the voting rights. American Raceways Inc. will have 54% of the voting rights for which it will have invested 52% of the equity capital of the Company. The public will have invested $1,098,900, or 46% of the equity capital, for which it will receive 43% of the equity interest and 43% of the voting rights, plus $3,300,000 in 8% Participating Subordinated Debentures, for which it will receive no equity interest and will receive no voting rights except in certain events of default, as hereinabove described in Paragraph 1 under this caption.

The Debentures will, however, be entitled to receive the Income Participation Premium, if any, hereinabove described in Paragraph 1 under this caption. (See also captions "Capitalization" and "Description of Debentures" herein.)

8. The development and operation of an automobile race track is a venturesome business, dependent upon the availability of sanctions, suitable weather conditions on scheduled racing dates and the ability to attract enough drivers and spectators to enable it to operate profitably, as well as the changing desires of the public for various types of entertainment and competition of other similar enterprises.

9. The Company has entered into a Management Agreement with its parent, American Raceways Inc., pursuant to which it will pay American Raceways Inc. for executive and administrative management of the Company. In all probability, the officers of the Company, other than the General Manager of its facility, will devote a majority of their time to other businesses, primarily to the business of the parent of the Company and other tracks owned or managed by the parent. However, under the Management Agreement the Company will reimburse the parent for only a portion of the salaries of these officers. They will receive no salaries from the Company, but will be compensated solely by the parent. It is estimated that the amount which will be paid by the Company to the parent for these services during the period prior to December 1, 1969 will be approximately $134,955. After November 30, 1969 (it being anticipated that the Company will commence operations on November 9, 1969) the Company will reimburse the parent for the same proportion of the parent's executive office overhead as the revenues of the Company bear to the revenues of all tracks which the parent

manages, including any tracks owned by the parent, but not in excess of $75,000 per year. This formula for reimbursement of the parent was determined by the parent and the officers and directors of the other tracks with which it has negotiated a management agreement, as being the formula most likely to reflect the relative value of such services to the various tracks. All of the management agreements will expire on November 30, 1970, at which time they may be renegotiated based upon experience during the preceding period. (See caption "Transactions With Affiliated Persons" herein.)

USE OF PROCEEDS

The total net proceeds to the Company from all of its financings, including its previous financing and this offering (after deduction of Underwriters' discount and expenses and other expenses in connection with this offering) are as follows:

Proceeds of this Offering:

Proceeds of sale of $3,300,000 Participating Subordinated Debentures and 330,000 shares of Common Stock		$4,398,900
Less: Underwriters' discount and expenses	$420,915	
Other expenses in connection with this offering	140,000	560,915
		$3,837,985
Proceeds of previous financing (see captions "Capitalization" and "Organization Transactions" herein)		1,300,500
		$5,138,485

As of September 15, 1969 the Company had applied such proceeds, or estimated that such proceeds would be applied by it, for the following purposes:

	Fixed Amounts(1)	Estimates	Total
Cost of real estate	$1,119,120		$1,119,120
Clearing, grading and excavating site	1,413,687		1,413,687
Paving	130,697	$576,631(2)	707,328
Safety and pit walls, fences, vehicle and press tunnels, water and sewer systems and guard rail	542,119	332,970(3)	875,089
Grandstand and press facilities	594,421	19,322	613,743
Shops, tune-up and concession buildings	167,708	18,600	186,308
Other construction costs (includes $100,000 fee to American Raceways Inc.)	248,816	15,247	264,063
Construction and other contingencies		75,000	75,000
Engineering services	156,536	83,464	240,000
Racing sanction costs	350,000		350,000
Estimated promotional and other administrative expenses to opening date (includes estimate of payments of $134,955 to American Raceways Inc.)	185,674	219,326	405,000
Total costs and expenses	$4,908,778	$1,340,560	$6,249,338
Less: Portion of above being financed by:			
6% Secured Promissory Notes (4)		$967,223(5)	
Deferral of liability for racing sanction costs		237,500(6)	1,204,723
			$5,044,615
Balance of net proceeds available for general corporate purposes			93,870
			$5,138,485

(1) Fixed amounts are based upon fixed price contracts and upon unit price contracts and other contracts where work has been completed and invoiced.

(2) Entire amount based on a unit price contract.

(3) Consists of $59,580 based upon unit price contracts and $273,390 based upon estimated completion costs.

(4) See caption "Capitalization" herein.

(5) Amount owing to Noteholders as of opening date (see Note C of Notes to Financial Statements).

(6) Amount owing to sanctioning body as of opening date (see Note B of Notes to Financial Statements).

Unit price contracts referred to above are contracts which have a fixed price per unit of measurement such as cubic yard, square yard, lineal foot, etc. with the number of units being estimated from engineering drawings, topographical surveys, etc. and the actual number of units paid for being determined when the work is completed. Estimated costs set forth above are based on the estimates of the Company and Spencer J. Buchanan & Associates, Inc., the engineers who prepared the plans and specifications for the facility. The Company and its engineers believe these estimates to be accurate and that the sums allowed for contingencies are sufficient. It is possible, however, that actual construction costs could exceed such estimates, including contingencies, and if this should occur the Company would have to secure additional financing to the extent of such excess. The parent of the Company, American Raceways Inc., has undertaken with the Company that in the event that the Company does not receive funds from this offering, its previous financing and other sources available to it sufficient to complete construction of its facility, American Raceways Inc. will advance monies to the Company in amounts sufficient to complete the facility and place it in operation. Any such funds so advanced will be repayable on demand with interest at the then current rate being charged or which would be charged to the Company by other lenders. There

can be no representation or assurance that, if such event should occur, American Raceways Inc. will have sufficient funds to honor its undertaking.

Until the proceeds of the sale of the securities offered hereby are used, the Company intends to invest them in short-term governmental securities or certificates of deposit. Use of the interest on such investments has been included in the Company's estimated financial requirements.

CAPITALIZATION

The following table shows the capitalization of the Company as at September 30, 1969 and as adjusted to give effect to the sale of the shares of Common Stock and Debentures offered hereby:

	Authorized	Outstanding	As Adjusted
Debt:			
8% Participating Subordinated Debentures (1)	$3,300,000	-0-	$3,300,000
6% Secured Promissory Notes (1)(2)	$1,017,223	$1,017,223	$1,017,223
Capital Stock:			
Common Stock, $1.00 par value	2,500,000 shs.	433,500 shs.	763,500 shs.(3)

(1) See Note F of Notes to Financial Statements for annual interest requirements.

(2) The Company is indebted to the sellers of its real estate (see caption "Plant and Property" herein) upon two 6% Promissory Notes in the amounts of $397,329.50 and $619,893.50 secured by Deeds of Trust to the real estate and vendor's liens. The Note for $397,329.50 is payable $50,000, plus accrued interest, on or before November 10, 1969 and the balance in five equal annual installments of $69,465.90, plus accrued interest, on September 20 in the years 1970 through 1974. The Note for $619,893.50 is payable in ten equal annual installments of $61,989.35,

plus accrued interest, on April 20 in the years 1970 through 1979. The Deeds of Trust contain customary provisions for acceleration of the indebtedness upon default and sale of the real estate to satisfy the debt.

(3) Does not include 8,000 shares reserved for exercise of an option (see caption "Options and Warrants" herein) and 23,000 shares reserved for issuance upon exercise of a warrant to be issued to Ladenburg, Thalmann & Co., the Representative of the Underwriters, in its individual capacity (see caption "Underwriting" herein).

HISTORY AND BUSINESS

The Company

Texas International Speedway, Inc. (the Company), having its business office at 2990 West Grand Boulevard, Detroit, Michigan, was incorporated under the laws of the State of Texas on January 13, 1969 as Texas Motor Sports, Inc. Its name was changed to Texas International Speedway, Inc. on May 19, 1969. The Company was incorporated by nominees on behalf of American Raceways Inc. (formerly Michigan International Speedway, Inc.), a Delaware corporation, which owns 412,500 shares of the 433,500 shares of presently outstanding Common Stock, $1.00 par value, of the Company and which will, after sale of the shares offered hereby, own 412,500 shares out of 763,500 shares then outstanding, or 54% of the voting stock of the Company. American Raceways Inc. was incorporated on August 17, 1967 and thereafter constructed an automobile racing facility approximately sixty miles west of Detroit, Michigan, known as Michigan International Speedway, where it conducts automobile racing and automobile testing activities identical to those proposed to be carried on by the Company. Michigan International Speedway commenced operations on October 13, 1968.

The facility being constructed by the Company is substantially the same as that constructed and operated by American Raceways Inc. at Michigan International Speedway.

Proposed Business

The Company was organized for the purpose of constructing and operating an automobile racing facility in the area of Bryan-College Station, Texas (see Map, page 15). The facility will consist of a two mile semi-banked oval speedway track and a 2.75 mile road track. The Company proposes to hold stock car racing, championship car racing, and road racing at the facility. During 1969, the Company proposes to hold a Canadian-American Challenge Cup Race on November 9 and a 500 Mile Grand National Stock Car Race on December 7. The Company has received a sanction from the Sports Car Club of America, Incorporated (SCCA) for the race proposed to be held on November 9 and has entered into an agreement with the National Association for Stock Car Auto Racing, Inc. (NASCAR) whereby NASCAR has agreed to grant to the Company sanctions for two Grand National Stock Car Races each year during the next ten years, including the race proposed to be held on December 7, 1969. Such sanction has not yet been issued. (See Paragraph 6 under caption "Introductory Statement" herein and sub-captions "Sanctions and Prizes" under this caption.) In addition, the Company plans to lease the facility to automobile, automotive parts, tire and gasoline companies for use as test facilities and in connection with their racing programs. No commitments or negotiations for such leasing have been entered into, and there is no assurance that the Company will be able to obtain such commitments. In this connection, it should be noted that

the three major automobile manufacturers have test facilities of their own.

Automobile Racing

Automobile racing in the United States and throughout the world is carried on in many variations and classifications but may generally be divided into three categories: speedway or closed circuit racing using specially constructed oval or oblong tracks, frequently banked, or semi-banked, on the turns; road racing over courses having turns, hills, etc. simulating highway conditions, which courses may be specially constructed or may utilize, at least in part, existing roads; and dragway racing, which is acceleration racing over a straightaway track constructed for that purpose or held on abandoned aircraft runways or similar available facilities. A special category of road racing is Grand Prix racing, which is technically a form of road racing using a highly specialized vehicle designed for this purpose and meeting set specifications. In the United States and Canada, however, this term is frequently used in connection with, and associated with, all forms of specialized road racing. The Company's facility is being designed to be qualified and used for all types of speedway and road racing but not for dragway racing.

The vehicles used for automobile racing come in almost infinite variations, classifications and subclassifications but they may be grouped in the major categories of Championship (or Indianapolis) type cars, specially constructed racing machines designed primarily for speedway racing; sprint cars and midget cars which are smaller versions of Championship cars used on speedways of a mile or less in length; Grand Prix cars, specially constructed single seat, open wheel and open cockpit racing machines designed primarily for road racing and meeting set specifications in

various classes; sports cars, any high performance vehicles suitable for road racing but technically, if only theoretically, equipped and suitable for highway driving; stock cars, production vehicles modified within specified limitations and used mostly in speedway racing; hot rods, highly modified production vehicles used primarily in speedway racing; and dragsters, vehicles especially constructed, or modified from production cars, for acceleration racing only. A major sub-classification of sports cars, which during the past three years has become the most popular road-racing vehicle in North America, is Group 7 sports cars, which are unlimited vehicles, using U.S. power plants, and raced in such events as the Canadian-American Challenge Cup series.

The Company intends to present events for all types of cars except hot rods and dragsters. Consideration will be given to presenting events for these vehicles in the future if public acceptance seems to justify the same.

Sanctions

All official automobile racing in the world is carried on under sanctions from one of the recognized sanctioning bodies. The success of automobile racing is dependent upon obtaining sanctions from a recognized sanctioning organization, as all established race drivers belong to these organizations and will not participate in a race unless it is sanctioned by the organization to which they belong. Sanctions are granted in the discretion of these organizations based upon avoiding conflicting racing dates in any area, staggering of major race dates so as to permit drivers to maintain and repair their cars between races and avoiding saturation of racing in any area.

The recognized international sanctioning organization is the Federation Internationale de L'Automobile (FIA) whose U.S. arm is the Automobile Competition Committee for the United States (ACCUS). The members of ACCUS are NASCAR, SCCA, the United States Auto Club (USAC) and the National Hot Rod Association (NHRA). Licensed driver members of these organizations may participate only in events sanctioned by their organization unless the event also has FIA sanctions in which case all drivers who hold an FIA license may participate regardless of the member organization to which they belong. As set forth above, the Company has obtained an SCCA sanction for a Canadian-American Challenge Cup Race on November 9, 1969 and has entered into an agreement with NASCAR for a NASCAR sanction for a 500 Mile Grand National Stock Car Race on December 7, 1969. (See Paragraph 6 under the caption "Introductory Statement" herein.) The Canadian-American Challenge Cup Race will also have FIA sanctions. The Company's contract with NASCAR is a 10 year contract for the granting of sanctions to the Company to hold NASCAR Grand National Stock Car Races in June and December each year. The Company must pay sanction fees to the sanctioning bodies for each race. These fees are set by negotiation with the sanctioning body and include the cost of compensation of officials assigned to the race by the sanctioning body. The sanction fee for the Canadian-American Challenge Cup Race scheduled to be run on November 9, 1969 has been set at $7,250. The sanction fee for the NASCAR race scheduled to be run on December 7, 1969 has not been fixed, but under the agreement with NASCAR described above, sanction fees to be charged to the Company shall be the same as customarily charged by NASCAR in the year of the event. Based upon its experience, the Company anticipates that the sanction fee for the NASCAR race

scheduled to be run on December 7, 1969 will be $11,775. The December race will be the final race on the NASCAR program each year. Under the terms of the NASCAR Agreement, NASCAR agrees that it will not sanction any Grand National race within 225 miles of Bryan, Texas within 15 days before or 13 days after the June race or within 15 days before or 30 days after the December race. In consideration of this agreement the Company paid NASCAR $100,000 and agreed to pay it the additional amount of $25,000 each year of the agreement. This sum is in addition to the sanction fee required to be paid for each race.

The Company intends to seek additional sanctions from other organizations in future years but there can be no assurance that such sanctions will be obtained.

Personnel

Mr. Lawrence H. LoPatin, President of the Company, is responsible for the planning and financing of the construction of the Company's facility and will be chief executive officer of the Company after it commences operations. Mr. LoPatin is also President of American Raceways Inc., for which he has performed the same services, Chairman of the Board of Atlanta International Raceway, Inc., Atlanta, Georgia and a Director of Riverside International Raceway, Riverside, California. He is also a self-employed real estate broker, developer and manager, mortgage broker and financial consultant. Mr. LoPatin has been, as an individual, corporate officer and partner, instrumental in the planning, financing, development, construction and management of residential subdivisions, shopping centers and apartment houses and the conversion and modernization of office buildings in the Detroit, Michigan area. From 1964 to 1966, Mr. LoPatin

also served as planning and financial consultant during the construction and initial operation of Windsor Raceway, a harness racing track in Windsor, Ontario. Mr. LoPatin also served as Vice President and Treasurer of that company.

Mr. Leslie Share, Executive Vice President of the Company, is responsible for supervision of construction of the Company's facility and for future construction, development and operation of its property. Mr. Share is also Executive Vice President of American Raceways Inc., for which he has performed the same services, Executive Vice-President of Atlanta International Raceway, Inc. and a Director of Riverside International Raceway. For fifteen years prior to the organization of American Raceways Inc. he was principal executive officer of Hamilton Construction Co., a company engaged in the acquisition and development of real estate for residential subdivisions, apartment buildings, shopping centers, urban renewal projects and public housing units for the United States Public Housing Administration and various Michigan municipalities. In such capacity Mr. Share had overall responsibility for all phases of such projects, including land acquisition, market survey and selection and supervision of field construction personnel.

Mr. Leo B. Margolian is Vice President of the Company and General Manager of the Company's facility. Mr. Margolian, an engineering graduate of Purdue University, was formerly General Manager of Stardust International Raceway, Las Vegas, Nevada, from its inception in 1964, and was responsible for supervision of the construction of Stardust International Raceway. Mr. Margolian is assisting Mr. Share in the construction and development of the Company's facility.

The operating officers of the corporation, other than Mr. Margolian who will devote his full time to the affairs of the Company, will divide their time between the affairs of the Company and the affairs of the other companies with whom American Raceways Inc. is or will be affiliated and to whom it provides or will provide management services, including American Raceways Inc. itself. American Raceways Inc. presently owns and operates Michigan International Speedway in the Detroit, Michigan area, owns 48.4% of the Common Stock of Riverside International Raceway (and warrants to purchase an additional 2% of its Common Stock) and owns 18% of the Common Stock of Atlanta International Raceway, Inc. (and convertible debt and warrants of Atlanta International Raceway, Inc. which if presently exercised would give American Raceways Inc. ownership of 52% of the Common Stock of Atlanta International Raceway, Inc.). Riverside International Raceway owns and operates an automobile race track in the Los Angeles, California area, and Atlanta International Raceway, Inc. owns and operates an automobile race track in the Atlanta, Georgia area. Amerian Raceways Inc. provides executive and administrative management to Riverside International Raceway and Atlanta International Raceway, Inc. under management agreements entered into or proposed to be entered into by American Raceways, Inc. with these companies which are or will be substantially identical to the Management Agreement entered into between the Company and American Raceways Inc., except that the management agreement as presently proposed by Riverside International Raceway reserves the right in the Board of Directors of Riverside International Raceway to approve the expenditures of American Raceways Inc. for executive office overhead. Under agreements entered into between American Raceways, Inc. and a major-

ity of the other shareholders of Riverside International Raceway, such other shareholders have agreed to vote their stock for a period of six years from May, 1969 so us to elect nominees of American Raceways Inc. as a minimum majority of the Board of Directors of Riverside International Raceway. In addition, American Raceways Inc. has, through a nominee, contracted to purchase real estate in New Jersey upon which it proposes to construct, through a subsidiary corporation, Eastern International Speedway, Inc., another automobile racing facility. It is anticipated that similar management arrangements will be entered into with Eastern International Speedway, Inc. The executive officers and administrative personnel of American Raceways Inc. will devote so much of their time to the affairs of each company as such officers shall determine to be necessary to the proper management of the companies, but it is impossible to estimate at this time what percentage of their time, and the time of other personnel, will be devoted to each company.

Prizes

Most automobile racing is conducted for cash prizes provided by the track or by a sponsoring company as part of its advertising or promotional campaigns. The amount of prize money paid is negotiated with the sanctioning bodies and is based on prevailing prize money for similar races at other tracks. The prize money the Company will pay for its scheduled Canadian-American Challenge Cup race in 1969 will be $60,000. Under the agreement between the Company and NASCAR, the prize monies to be paid by the Company for NASCAR races will be the same as is customarily paid for similar races during the same year. Based upon its experience, the Company anticipates that the prize money it will pay for its NASCAR race in 1969 will be approximately $65,000 to $75,000. (See Paragraph 6 under caption "Introductory Statement" herein.)

Sources of Revenue

It is anticipated that the revenues of the Company will be derived principally from admissions, and that additional revenues will be received from concessions, rentals from tire, gasoline and automotive companies, the sale of programs and program and billboard advertising. No rental agreements or any agreements with regard to advertising have been entered into. There is no assurance that any such agreements can be obtained or that the revenues derived from the sources described above will be sufficient to render the Company's operations profitable. (See subcaption "Concession Agreement" under this caption.)

The Company intends to charge from $10.00 to $25.00 per person for grandstand seats and from $6.00 to $8.00 per person for admission to the infield, depending upon the type of race being presented. The Company believes these prices are substantially comparable to those charged by other similar facilities.

As of October 27, 1969, the Company had received approximately $26,000 from the sale of tickets for the Canadian-American Challenge Cup race scheduled to be held on November 9, 1969 and approximately $29,000 from the sale of tickets for the NASCAR race scheduled to be held on December 7, 1969. These receipts should not be deemed to be indicative of the revenues which might be received from either of these races and, in the event that, for any reason, either or both of such races should not be held, the moneys received from the ticket sales for such race or races would have to be refunded.

The price charged for admission, as well as rentals, concession prices, advertising and prize money, could be adjusted to meet competitive conditions or to attract patronage.

Concession Agreement

The Company proposes to enter into a concession agreement with Ogden Foods, Inc., a national company engaged in this field. Under the terms of this proposed agreement, the Company will grant to the concessionaire the exclusive right for a period of ten years commencing November 4, 1969 to sell food, beverages and tobacco products at the Company's facility in exchange for 25% of the concessionaire's gross receipts from such sales (exclusive of tobacco sales) and a loan of $75,000, to be advanced in two installments, $37,500 at the time of execution of the agreement and $37,500 at the time the concessionaire commences operations. Such loan is to be repaid in semi-annual principal installments of $3,750 each, commencing January 1, 1971, together with interest at a rate equal to 1% above the prime rate in effect from time to time at major New York banks. (At the present time the interest rate will be 9½%.) Should the Company fail to commence operations at its facility prior to December 1, 1969, such loan shall be immediately due and payable. Other concessions, such as the sale of programs, souvenirs and novelties, will be operated directly by the Company, and all revenues therefrom will be received directly by the Company.

Competition

There are no other major speedway or road racing facilities in the State of Texas, and the nearest major facility in either category to the Company's facility is at Talladega, Alabama, which is approximately 650 miles from Texas International Speedway. The other major tracks closest to the Company's facility (and the distances from it) are located in Phoenix, Arizona (900 miles), Indianapolis, Indiana (850 miles) and Atlanta, Georgia (750

miles). There are numerous minor speedways, road courses and other types of racing faciliites throughout Texas and the Southwest, but none of these has ever presented a major sanctioned racing event, or, to the Company's knowledge, has, or intends to construct, facilities for such an event. Under the prevailing policies of the sanctioning bodies described above, no other major event will be sanctioned by these bodies on dates approximating those granted to the Company, but it should be noted that the Company will be competing for patronage with all other seasonal sporting events.

Insurance

In addition to normal insurance coverage, such as casualty insurance on the track facilities and equipment and workmen's compensation insurance, the Company will carry liability insurance for property damage and public liability in the amount of $1,000,000 for each person and $10,000,000 for each occurrence. The estimated insurance premiums for the first year of operation are $20,000 to $25,000.

PLANT AND PROPERTY

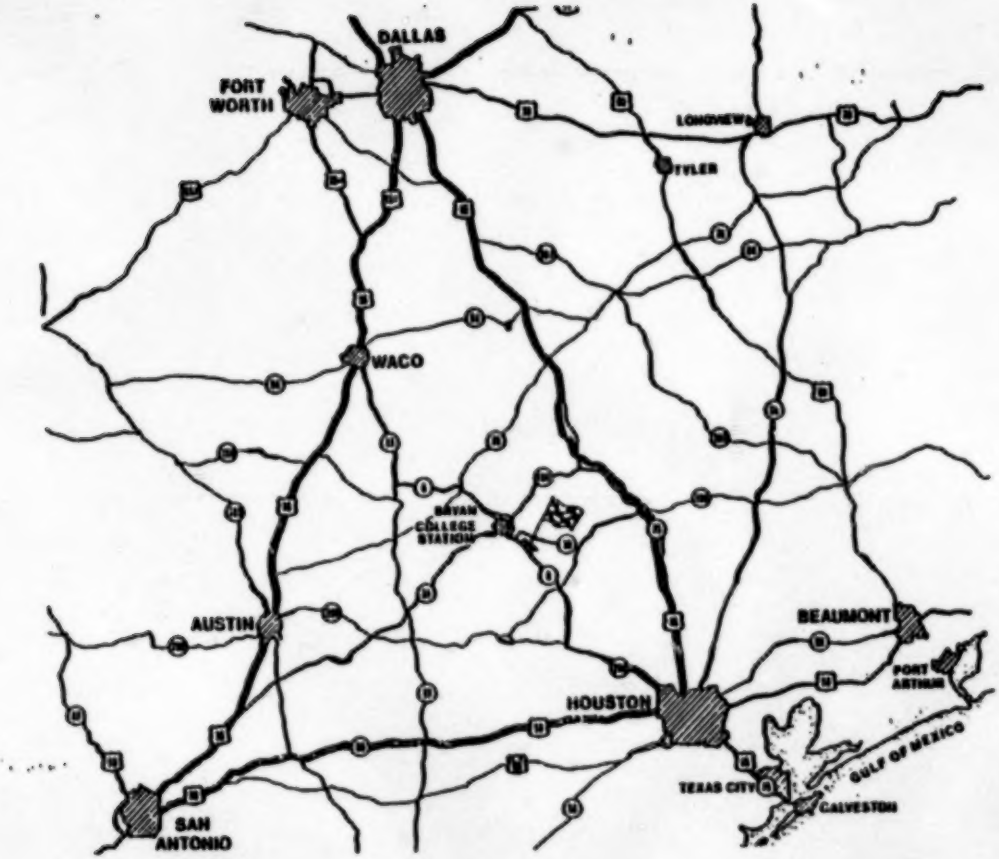
The Company acquired approximately 2,600 acres of land in Brazos County, Texas for construction of its facility. Contracts for acquisition of the real estate were originally entered into by Lawrence H. LoPatin, President of Texas International Speedway, Inc. and of American Raceways Inc. as nominee for Michigan International Speedway, Inc. (now American Raceways Inc.). The real estate was subsequently transferred to Michigan International Speedway, Inc. and then to Texas International Speedway, Inc. at the cost thereof. The cost of the real estate, including expenses in connection with

the acquisition thereof, was $1,119,120, of which $1,017,223 is still owed to the sellers upon Promissory Notes secured by Deeds of Trust and vendor's liens. (See Caption "Capitalization" herein.) Two individuals who are not associated in any matter with the sellers of the real estate or with the Company or American Raceways Inc., or the officers or directors of either, claim a fee in connection with the purchase of the real estate, any liability for which was assumed by the Company as part of the purchase price, for alleged services in introducing the officers of the Company to the sellers. (See caption "Litigation" herein for a description of the action pending in connection with such claim.)

The real estate consists of gently rolling ranch (grazing) land traversed by several live streams, which will provide for positive drainage. Approximately 800 acres of the land are being used for track facilities, with the remainder being available for future development, sale or other purposes. No plans for other use or sale have been made at this time.

The site of the facility is approximately ten miles from Bryan, Texas, five miles from College Station, Texas, 69 miles from Houston, Texas, 166 miles from Dallas, Texas and 167 miles from San Antonio, Texas, and is located approximately 45 miles from U.S. 45, 80 miles from U.S. 35 and 60 miles from U.S. 10 on Texas Highway 6. It is accessible by improved state highways from all directions (see Map page 15). Based upon growth projections since the 1960 U.S. census, it is estimated that there is a population of approximately 7,800,000 people within a 300 mile radius of Bryan-College Station, Texas.

The Company's tracks are based on the designs of the tracks at Michigan International Speedway. Basic design studies for the speedway track were prepared by Charles


DALLAS
FORT WORTH
LONGVIEW
TYLER
WACO
BRYAN
COLLEGE STATION
AUSTIN
BEAUMONT
PORT ARTHUR
HOUSTON
GULF OF MEXICO
TEXAS CITY
GALVESTON
SAN ANTONIO

Moneypenny of Daytona Beach, Florida, who is generally recognized as one of the leading automobile speedway designers in the world. Mr. Moneypenny, who has specialized in this field of design for the past 10 years, designed Daytona International Speedway, Michigan International Speedway and other speedway and road racing circuits in Arizona, Oklahoma and Japan and has served as consultant to other United States automobile tracks. The configuration of the road racing track was determined by the Company after meeting with SCCA officials, racing drivers and other persons participating in road racing, on the basis of a configuration which appears to best suit racing purposes and spectator appeal. Preparation of working drawings for the Company's tracks as well as field supervision, quality control testing and civil engineering are the responsibility of Spencer J. Buchanan & Associates, Inc., Bryan, Texas, which corporation was retained by the Company for this purpose and is presently engaged in the work. Spencer J. Buchanan & Associates, Inc. is an engineering firm of international reputation with extensive experience in the fields for which it is performing services for the Company. Garage buildings, concession stands, rest rooms and other miscellaneous buildings are pre-engineered steel buildings purchased and erected on a bid basis.

At September 30, 1969 all grading, excavation and storm drainage work had been completed and paving commenced; and construction of concrete safety walls, vehicular and press tunnels and garage buildings had been completed. At that date construction of the grandstand and other facilities was approximately 50% completed, and the project as a whole was approximately 80% complete. At the date hereof all unfinished work was on or ahead of schedule.

Speedway Track

The speedway track is a semi-banked "D" shaped oval two miles in length, 70 ft. wide on the turns and 54 ft. wide on the straightaways, with a 12ft. apron all around. It is banked 22° on the turns and 12° on the front stretch and is flat on the back stretch. The Company believes that the design of the track qualifies it for all types of speedway racing. Michigan International Speedway is a two mile "D" shaped oval of substantially the same dimensions. Indianapolis Motor Speedway is a two and one-half mile oval varying from 50ft. in width on the straightaways to 60 ft. on the turns, and is banked 9.2° on the turns. Daytona International Speedway is a two and one-half mile tri-oval 45 ft. wide, with a 22 ft. apron on the straightaways and on the turns, and is banked 31° on the turns.

The track is constructed of 5½ in. of specially designed and carefully prepared layers of asphalt laid upon a lime stabilized sub-base. There is a pit road 50 ft. wide for servicing vehicles during racing. The track is surrounded by a concrete or steel safety wall outside of the oval, and, in addition, a 9 ft. welded wire mesh fence is being erected in front of spectator areas. Outside of the entire oval will be a 10 ft. security fence. A 6 ft. fence will surround the infield of the oval and a 4 ft. fence will surround the road course to provide a safety zone for spectators.

Parking facilities for approximately 25,000 cars will be provided, initially, on graded areas of the infield and outside of the oval. Substantially unlimited additional areas could, of course, be improved for parking if the need should arise.

Access to the track will be over sealed gravel access roads, and there are two 2 lane tunnels, with pedestrian

walkways, from the grandstand side of the track to the infield. There is also a pedestrian tunnel from the grandstand area to pit area for press and officials.

Road Track

The road track is approximately 2.75 miles long and of substantially the same construction as the oval. The road track is 32 ft. wide with approximately two miles of the track outside of the oval and the remainder in the infield of the speedway track and utilizes the main straightaway so that cars on the road racing track will pass in front of the grandstand. The configuration of the road track was based upon the experience of the officials of the Company in construction and operation of Michigan International Speedway, after consultation with other participants in road racing, and was designed to utilize the contours of the property so as to provide substantially 100% visability of the road track from the grandstand.

Other Facilities

A 30 row grandstand containing approximately 25,900 permanent seats is being constructed by placing grade beams on an embankment created by grading. Treads and risers are precast concrete sections and the seats will be aluminum with aluminum backs. Leased temporary bleachers can be used if required, on each side of the grandstand on the main straightaway, on the back stretch and on the road track. The number of leased bleachers to be used for various events would depend upon the anticipated patronage for the event, but there is no practical limitation on the number of seats which could be provided in this manner. Based upon the experience of the officials of the Company at Michigan International Speedway and the experience of other tracks, it is estimated that more

than 50% of the spectators at an automobile race watch from ground level in the infield, and the infield of Texas International Speedway is more than adequate to accommodate the maximum number of infield spectators that is anticipated. Press box and control tower facilities are being constructed at the top of the grandstand, and rest room and concession facilities are being constructed above and at the rear of the grandstand. Approximately 15,000 sq. ft. of garage buildings have been constructed in the infield, and rest room facilities, concession stands, field hospital and miscellaneous administration and service buildings are also being constructed in the infield. All buildings are pre-engineered steel buildings purchased and erected on a bid basis.

DESCRIPTION OF COMMON STOCK

The authorized capital stock of the Company consists of 2,500,000 shares of Common Stock, $1.00 par value. The Common Stock, which, when issued, will be fully paid and non-assessable, is entitled to one vote per share, with cumulative voting, to all dividends which may be declared by the Board of Directors from funds legally available for payment thereof, to all distributions in liquidation and to all other rights incident to the ownership of Common Stock. Cumulative voting means that a shareholder may cast for the election of one director a number of votes equal to the number of shares he owns multiplied by the total number of directors to be elected. (See captions "Introductory Statement" and "Description of Debentures" herein for the voting rights of the Debentureholders upon the happening of certain events of default under the Indenture.) Under the terms of the Indenture no dividends, other than dividends payable in capital stock, may be paid. (See caption "Description of Debentures" herein.)

The holders of Common Stock have no pre-emptive rights to purchase any other securities issued by the Company.

DESCRIPTION OF DEBENTURES

The statements in this section relating to the Debentures and to the Indenture are summaries and do not purport to be complete. Such summaries make use of defined terms and are qualified in their entirety by reference to the Indenture, a copy of which has been filed as an exhibit to the Registration Statement.

The Debentures are to be issued under an Indenture to be dated as of October 15, 1969 between the Company and National Bank of Commerce of Dallas (of Dallas, Texas), as Trustee. The Debentures will be dated as of October 15, 1969, will bear interest from October 15, 1969 at the rate of 8% per annum, payable quarterly, on the 15th day of October, January, April and July of each year commencing on April 15, 1970, and will mature on October 15, 1984. Principal and interest will be payable in the City of Dallas, Texas at the principal office of the Trustee, and interest may at the option of the Company be paid, without presentation of Debentures, to or upon the order of the registered holders thereof by checks mailed to their addresses. Payment of principal, Income Participation Premium, if any, and interest on the Debentures will be subordinated to the payment of certain other indebtedness as hereinafter described. The first payment of interest will not be made until April 15, 1970, at which time interest for the period October 15, 1969 to April 15, 1970 will be paid.

The Debentures are to be issued as registered Debentures in denominations of $1,000 or any integral multiple thereof.

Subordination of Debentures

The payment of the principal, Income Participation Premium, if any, and interest on the Debentures is subordinated in right of payment to the prior payment in full of all Senior Indebtedness, whether now outstanding or hereafter incurred, upon default in payment thereof, or in the event of dissolution, liquidation, reorganization in bankruptcy or similar proceedings. Senior Indebtedness is defined in the Indenture as the principal of, premium, if any, and interest on all indebtedness of the Company to financial institutions, whether short term or long term and whether secured or unsecured, which is expressly provided to bear a right of repayment that is prior to the Debentures; purchase money obligations for property and equipment purchased by the Company, whether secured or unsecured, evidenced by promissory notes, mortgages or other written evidences of indebtedness of the Company; and renewals, extensions, refundings, amendments and modifications of any such indebtedness or obligation; unless by the terms of the instrument creating such indebtedness or obligation or such renewal, extension, refunding, amendment and modification, it is provided that such indebtedness or obligation is not superior in right of payment to the Debentures.

Redemption and Sinking Fund Provisions

The Debentures are redeemable by the Company at any time after October 31, 1971 without premium, except that upon redemption, whether at or prior to maturity and whether through operation of the sinking fund, hereinafter described, or otherwise, the Debentures are entitled to an Income Participation Premium of the pro-rata

portion of each Debenture in 1% of the net income, if any, of the Company and its subsidiaries, for the period from the date of the Indenture to the close of the fiscal year next preceding the date of maturity or redemption for each $100,000 of Debentures then outstanding. Net income for this purpose means the aggregate consolidated net income of the Company and its subsidiaries for the fiscal years included in the period since the date of the Indenture, after deducting any consolidated losses in any of the fiscal years, as determined by the Company's independent certified public accountants and reported to shareholders in the annual reports of the Company. Based upon the total amount of the Debentures being offered, this Income Participation Premium will amount initially to 33% of any such net income. It is believed this premium will be taxable to the Debentureholder as ordinary income and not as a capital gain. (See Paragraph 1 under caption "Introductory Statement" herein.)

Subject to the subordination provisions, the Company will pay, as a sinking fund, in cash or by delivery of Debentures, including Debentures purchased by the Company or redeemed as hereinbefore provided, on October 15 in each year commencing with the year 1973 and ending with the year 1983 the sum of $275,000 of the total principal amount of Debentures outstanding, plus Income Participation Premium, if any.

Restrictions on Dividends and Acquisition of Stock

The Indenture prohibits the declaration or payment of any dividend or other distribution on any shares of any class of capital stock of the Company (other than dividends or distributions payable in shares of capital stock of the Company) or the purchase, redemption or

other acquisition or retirement for value of any shares of the Company's capital stock.

Other Special Covenants

The Indenture prohibits the Company from consolidating with, merging into, or selling or otherwise disposing of all or substantially all of the property of the Company as an entirety unless the successor formed by or resulting from such transaction shall be a corporation organized under the laws of the United States or any state, district or territory thereof, and unless such successor corporation shall assume payment of the principal, Income Participation Premium, if any, and interest on the Debentures and performance of all the terms, covenants and conditions of the Indenture and unless immediately after such transaction the Company or its successor shall not be in default in performance of any of the covenants, agreements and conditions contained in the Indenture or in the Debentures.

Events of Default and Notice Thereof

The following events are defined in the Indenture as "Events of Default": default in payment of interest and continuation of such default for a period of thirty days; default in payment of principal or Income Participation Premium; default in payment of sinking fund payments and continuation of such default for a period of thirty days; failure to perform any other covenant for sixty days after notice; certain events of bankruptcy, insolvency or reorganization; and an event of default as defined in any indenture or trust agreement securing or protecting any Senior Indebtedness resulting in acceleration of such Senior Indebtedness and failure to rescind or annul such acceleration or discharge the same within twenty days.

Upon the occurrence of an Event of Default, the Trustee or the holders of not less than 25% in principal amount of Debentures may, by notice in writing to the Company, declare the principal and Income Participation Premium, if any, of all the Debentures that are outstanding, and the interest accrued thereon, to be due and payable immediately.

The Indenture provides that the Trustee shall, within ninety days after the occurrence of a default, give notice to the Debentureholders of all uncured defaults, provided, that, except in the case of default in any payment of principal, Income Participation Premium, if any, or interest or in any sinking fund payment, the Trustee shall be protected in withholding such notice if it in good faith determines that the withholding of such notice is in the interests of the Debentureholders.

The holders of a majority in aggregate principal amount of the Debentures will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee.

Voting Rights

In the event of a default in payment of principal and Income Participation Premium, if any, or in payment of two or more successive installments of interest on the Debentures, or in the event of any corporate action by charter amendment or otherwise to alter, abridge or otherwise revise the voting rights of Debentureholders, the holders of Debentures shall have the right to vote at meetings of the stockholders of the Company, with one vote for each $50 principal amount of Debentures, in the manner, and subject to the provisions for such voting, set forth in the

Articles of Incorporation of the Company. (See caption "Introductory Statement" herein.)

Modification of the Indenture

The Indenture and the rights of Debentureholders may be modified by the Company and the Trustee with the consent of the holders of not less than 66⅔% in aggregate principal amount of Debentures then outstanding; but no modification may be made which will extend the maturity of any Debentures, reduce the principal amount thereof, reduce the rate or extend the time of payment of interest thereon or any Income Participation Premium payable upon the redemption thereof without the consent of the holder of each Debenture so affected, or reduce the percentage of Debentures the holders of which are required to consent to such modification without the consent of the holders of all Debentures then outstanding.

Deposit of Funds to Pay Interest

American Raceways Inc. has deposited in escrow with the Trustee under the Indenture a sum equal to one year's interest on the Debentures ($264,000) to be used to pay interest on the Debentures in the event that the Company shall fail to make any interest payment during the period the escrow remains in effect. The escrow will remain in effect until the Company shall have earnings for a full fiscal year equal to one year's interest on the Debentures then outstanding. American Raceways Inc. is not obligated to deposit or pay any amount in excess of the $264,000 deposited. The escrow agreement defines earnings as earnings before income tax expense for said fiscal period and before deduction for interest expense accrued upon the Debentures for said fiscal period. (See Paragraph 1 under caption "Introductory Statement" herein.)

Original Issue Discount

The Internal Revenue Service may determine that the Debentures contain "original issue discount" within the meaning of Section 1232 of the Internal Revenue Code. In such event, all or part of any gain realized upon any sale of the Debentures may be taxable as ordinary income rather than as capital gain. (See sub-caption "Redemption and Sinking Fund Provisions" under this caption.)

ORGANIZATIONAL TRANSACTIONS

American Raceways Inc. is the founder of the Company and has purchased 412,500 shares of its Common Stock, $1.00 par value, at a price of $3.00 per share. In addition, five individuals and Graham Loving & Co., a proposed Selected Dealer in this offering, have purchased an aggregate of 21,000 shares of the Common Stock at a price of $3.00 per share. All of the outstanding stock of the Company was sold for cash. The management of the Company deemed the sale of these shares to be desirable as an incentive to the purchasers to become associated with the Company. The association with the Company of Messrs. Tierney, Witts and Margolian, three of the purchasers, and of Graham Loving & Co. is described elsewhere in this Prospectus. (See sub-caption "Personnel" under caption "History and Business" and captions "Management" and "Underwriting" herein.) Leslie Richter, one of the purchasers, was a Director and Vice President – Operations of the Company and of American Raceways Inc. but resigned on October 20, 1969 as a result of a difference of opinion on management policy with other members of the management of the Company and of American Raceways Inc. John W. Mecom, Jr., one of the purchasers, was a Director of the Company but resigned on October 16, 1969 for personal reasons not associated

with the affairs of the Company.The following table sets forth the shares of Common Stock owned by all present stockholders of the Company and the amount paid for such shares:

Name	No. of Shares Owned	Total Purchase Price
American Raceways Inc.	412,500	$1,237,500
Graham Loving & Co.	10,000	30,000
Thomas J. Tierney	5,000	15,000
David A. Witts	3,000	9,000
John W. Mecom, Jr.	1,000	3,000
Leo B. Margolian	1,000	3,000
Leslie Richter	1,000	3,000
Total	433,500	$1,300,500

MANAGEMENT

Officers and Directors

The Directors and executive officers of the Company are as follows:

Lawrence H. LoPatin ..... President, Treasurer and Director
2990 W. Grand Boulevard
Detroit, Michigan 48202

Leslie Share ..... Executive Vice President and Director
2990 W. Grand Boulevard
Detroit, Michigan 48202

Leo B. Margolian ..... Vice President, General Manager and Director
410 Highway No. 6
College Station, Texas 77840

David A. Witts ..... Secretary and Director
1000 Empire Life Bldg.
Dallas, Texas 75201

George E. Kawamoto .....Director
46 Selden Street
Detroit, Michigan 48201

Thomas J. Tierney .....Director
Mercantile Dallas Bldg.
Dallas, Texas 75201

Robert O. McDonald.....Director
25 Broad Street
New York, New York 10004

There are two vacancies on the Board of Directors.

Lawrence H. LoPatin is President and Chief Executive Officer of American Raceways Inc. which has been his principal occupation since approximately January, 1968. Prior to that date, during the past five years, he was a self-employed real estate developer and manager and financial consultant.

Leslie Share is Executive Vice President of American Raceways Inc. which has been his principal occupation since approximately January, 1968. Prior to that date, during the past five years, he was president of Hamilton Construction Co., a company engaged in the acquisition of real estate and development thereof for residential housing, apartment buildings and shopping centers, including public housing units.

Leo B. Margolian, prior to his employment by the Company, was General Manager of Stardust International Raceway, Las Vegas, Nevada, which had been his principal occupation for the past five years.

David A. Witts has been a practicing attorney in Dallas, Texas for the past five years and is senior partner of Witts, Lee, Pletcher & Douglass, counsel for the Company.

George E. Kawamoto has for the past five years been a professional photographer specializing in automotive and automotive performance photography and public relations. He is also a Director and Secretary-Treasurer of American Raceways Inc.

Thomas J. Tierney has been President of Thomas J. Tierney and Associates, Inc., Dallas, Texas, public relations consultants, since 1967. Prior to that time he was from 1963 to 1964 Southwest regional public relations manager of the Ford Division of the Ford Motor Company, from 1964 to 1965 public relations manager for the Ford Division and from 1965 to 1967 assistant to the Vice President and General Manager of the Ford Division.

Robert O. McDonald has been a general partner of Ladenburg, Thalmann & Co., the Representative of the Underwriters, since January, 1969. From September, 1967 to December, 1968 he was a general partner of McDonald, Bennahum & Co., a New York investment banker. From January, 1964 to September, 1967, Mr. McDonald was a Vice President of Allen & Co., Inc., a New York investment banker.

Remuneration

No officer or director of the Company will receive aggregate remuneration in excess of $30,000 during the first fiscal year of the Company. Leo B. Margolian will receive a salary of $26,000 per year as Vice President of the Company and General Manager of the Company's facility. Mr. Margolian will be the only officer and Director to receive direct remuneration from the Company. (See caption "Transactions With Affiliated Persons" herein as to the remuneration of other executive officers of the Company.)

TRANSACTIONS WITH AFFILIATED PERSONS

The Company has entered into a Management Agreement with American Raceways Inc. under the terms of which American Raceways Inc. is furnishing executive and administrative management to the Company and other technical advice and assistance in the construction and placing in operation of the Company's facility. The Company will reimburse American Raceways Inc. for 25% of American Raceways Inc.'s executive office overhead (which includes the salaries of the executive officers, other managerial salaries, rent, administrative clerical salaries and secretarial salaries) for the period December 1, 1968 to November 30, 1969. The Company will also, within 60 days after commencing operations, pay to American Raceways Inc. a sum equal to 50% of the excess if any, of the pre-operating expenses of American Raceways Inc. from the date of its incorporation to the date of commencement of its operations for executive office overhead (as described above) and promotional and other administrative expenses (exclusive of such things as interest charges, transfer agent fees, etc.) over the comparable pre-operating expenses incurred by the Company during the period from the date of its incorporation to the date of commencement of its operations. In addition, the Company agreed to pay a fee of $100,000 to American Raceways Inc., of which $90,000 has been paid and the balance is payable on November 15, 1969, to reimburse American Raceways Inc. for the use of its construction plans and for technical advice to the Company during the construction of its facility.

From December 1, 1969 to November 30, 1970, the Company will pay to American Raceways Inc. that proportion of the executive office overhead of American Raceways Inc. which the gross revenues of the Company

bear to the gross revenues of all tracks to which American Raceways Inc. supplies executive and administrative management, but not more than $75,000 per year. American Raceways Inc. has entered into a management agreement with Atlanta International Raceway, Inc., is negotiating a management agreement with Riverside International Raceway and proposes to enter into a management agreement with Eastern International Speedway, Inc., which agreements are or will be substantially identical to the Management Agreement with the Company, except for those terms relating to the preoperating period of the Company and of Eastern International Speedway, Inc. and except for any different terms which may ultimately be negotiated with Riverside International Raceway. (See sub-caption "Personnel" under caption "History and Business" herein.) The executive offices of all of the companies will be maintained at the offices of American Raceways Inc. in Detroit, Michigan, and all executive and administrative functions of the Company will be performed by the officers and other executive and administrative personnel at such offices.

In determining the terms of the Management Agreement it was the estimate of the officers and Directors of the Company and of American Raceways Inc. that the officers and executive personnel of the Company, who receive their compensation from American Raceways Inc., had spent since December 1, 1968, and would continue to spend until commencement of operations of the Company's facility, not less than 25% of their time on the affairs of the Company and that accordingly American Raceways Inc. should be compensated for not less than 25% of its executive office overhead during this period. It was their further opinion that the experience gained by the personnel of American Raceways Inc. in organizing and

placing in operation at Michigan International Speedway a facility substantially the same as that being constructed by the Company would result in a savings in pre-operating expenses over that incurred by American Raceways Inc. and that if this should occur the savings should be shared with American Raceways Inc. At August 31, 1969 the Company had paid, or become obligated to pay, to American Raceways Inc. $70,744.46 for executive and administrative management services rendered to it based upon 25% of American Raceways Inc.'s executive office overhead for the period from December 1, 1968 to August 31, 1969. It is estimated that the Company will pay a total of $82,000 to American Raceways Inc. as its share of the executive office overhead of American Raceways Inc. for the entire period from December 1, 1968 to November 30, 1969 and that 50% of the savings of the Company in pre-operating expenses (which expenses are estimated at $294,801, including both the payment to American Raceways Inc. for executive and administrative management and other sums expended for promotional and other administrative expenses) over the comparable expenses of American Raceways Inc. ($400,711) will approximate $52,955 or an aggregate reimbursement to American Raceways Inc. (exclusive of the $100,000 payable for construction plans and technical advice hereinabove described and any repayment or reimbursement for the direct expenses and services hereinafter referred to) of $134,955.

In fixing the terms of the management agreements with Atlanta International Raceway, Inc. and Riverside International Raceway, and the terms of the Management Agreement with the Company for the period after commencement of operations of the Company, it was the opinion of the officers and directors of all of these companies that the most equitable formula which could be devised

for the sharing of executive office overhead, absent any actual experience, was to share such overhead on the basis of gross revenues as described above. It should be noted, however, that if the gross revenues of the Company increase,the percentage of the executive office overhead of American Raceways Inc. that the Company must pay will increase, regardless of the time spent on the Company's affairs by its officers and other executive and administrative personnel.

During the year ending November 30, 1969, which is the only full year of operation that American Raceways Inc. has experienced, it is estimated that its total executive office overhead subject to division among American Raceways Inc., Atlanta International Raceway, Inc., Riverside International Raceway and the Company will be approximately $328,000. The Company will pay 25% of this overhead. From December 1, 1969 to November 30, 1970, the Company will pay a percentage of the executive office overhead of American Raceways Inc. computed as set forth above. The amount of such payment cannot be predicted with accuracy but under the Management Agreement it cannot exceed $75,000. All of the management agreements will expire on November 30, 1970, but it is contemplated that new agreements will be negotiated at that time along similar lines but based upon experience under the present agreements. The Company will at all times repay American Raceways Inc. for any direct expenses of the Company advanced on its behalf by American Raceways Inc. and reimburse it for any direct services to the Company by employees of American Raceways Inc. whose compensation is not included in executive office overhead.

Thomas J. Tierney and Associates, Inc., of which Thomas J. Tierney, a Director of the Company, is Presi-

dent and principal stockholder, has furnished public relation services to the Company, fees for which amounted to $18,788.22 as of August 31, 1969.

Messrs. Witts, Lee, Pletcher & Douglass, of which David A. Witts, an officer and Director of the Company, is senior partner, have provided legal services to the Company, the fees for which amounted to $16,652.80 as of August 31, 1969.

Messrs. Lawrence H. LoPatin and Leslie Share, officers and Directors of the Company, and Mr. Dan Holloway, President of Holloway Sand & Gravel Co., Inc., a principal contractor for the Company, have entered into agreements to acquire approximately 1,300 acres of real estate in Brazos County, Texas, adjacent to the real estate owned by the Company. The opportunity to purchase this real estate was offered to the Company and American Raceways Inc., but the Boards of Directors of both Companies declined the opportunity because such real estate was not useful for the purposes of either corporation, was surplus to their needs and was in excess of their ability to purchase.

See caption "Organizational Transactions" herein for information with respect to purchases of shares of the Common Stock by persons affiliated with the Company.

OPTIONS AND WARRANTS

The Company has granted to Holloway Sand & Gravel Co., Inc. a conditional option to purchase 8,000 shares of Common Stock at a price of $3.00 per share at any time within five years after June 10, 1969. The condition of the option is that construction of the Company's facility be completed and in condition to pass SCCA and NASCAR inspections on or before October 24, 1969. The Company

is of the opinion that this condition has been met. The Company has also agreed to issue a warrant to purchase 23,000 shares of Common Stock to the Representative of the Underwriters in connection with the sale of the securities offered hereby. (See cover page and caption "Underwriting" herein.)

PRINCIPAL STOCKHOLDERS

The following table sets forth as of October 24, 1969 the securities owned of record or beneficially by each person who owns of record or beneficially more than 10% of any class of securities and by all directors and officers as a group.

Names and Addresses	Title of Class	Amount Owned of Record and Beneficially	Percent of Class
American Raceways Inc.....	Common	412,500 shs.	95.16
All Directors and officers as a group	Common	9,000 shs.	2.08
All Directors and officers as a group	Common Stock of Parent	176,620 shs.	20.17

LITIGATION

On September 30, 1969 Dr. Hascall H. Muntz and Dr. T.W. Lyles instituted suit in the 7th District Court of Texas against the Company and Lawrence H. LoPatin upon their claim for compensation for alleged services in connection with the purchase of the Company's real estate. (See caption "Plant and Property" herein.) The suit alleges a contract between the plaintiffs and Lawrence H. LoPatin, individually and on behalf of the Company, for services, the performance of such services and the incurring of expense in connection therewith. No specification of the nature or amounts of such services and expenses is made therein. The suit further alleges breach of the con-

tract by the defendants and seeks damages of $250,000 for such breach and the additional sum of $250,000 from Lawrence H. LoPatin as exemplary damages for allegedly wrongfully inducing the Company to breach the contract. In the opinion of special counsel to the Company, Messrs. Scholl, Jenkins, Robinson & Stieg, any recovery by the plaintiffs would not exceed $56,000. The Company and Mr. LoPatin deny any liability and intend to defend the suit against the entire claim.

In October, 1969 the Company was advised by Texas International Raceway, Inc., a Texas corporation, that it deemed the name of the Company to be so similar to its name as to be deceptive and misleading and claimed priority in the use of its name. Texas International Raceway, Inc., which operates a one-quarter mile automobile race track in Houston, Texas, for the racing of midget, modified and super-modified cars, has demanded that the Company cease using the name Texas International Speedway, Inc. and has threatened to institute legal action to enforce its rights if the Company does not comply. Texas International Raceway, Inc. was incorporated on January 10, 1967 at which time Texas International Speedway, Inc., a Texas corporation incorporated June 15, 1966, was in existence. The Company subsequently, in March, 1969, acquired the charter of the latter corporation and on May 19, 1969 changed its name from Texas Motor Sports, Inc. to Texas International Speedway, Inc. In the opinion of Messrs. Witts, Lee, Pletcher and Douglass, counsel for the Company, the claim of Texas International Raceway, Inc. is without merit.

There is no other material litigation pending against the Company, and the Company knows of no other litigation which is threatened.

UNDERWRITING

The Underwriters named below have severally agreed, upon the terms and conditions contained in the Underwriting Agreement (a copy of which is filed as an exhibit to the Registration Statement), to purchase from the Company the number of Units set forth below opposite their respective names. Subject to certain conditions set forth in the Underwriting Agreement, the Underwriters are committed to purchase all of the Units offered hereby.

Name of Underwriter	Address of Underwriter	Number of Units to be Purchased
Ladenburg, Thalmann & Co.	25 Broad Street New York, N.Y. 10004	1,070
Black & Company, Inc.	300 American Bank Bldg. Portland, Oregon 97205	50
D.H. Blair & Company	66 Beaver Street New York, New York 10004	30
Boettcher and Company	828 17th Street Denver, Colorado 80202	50
Butcher & Sherrerd	1500 Walnut Street Philadelphia, Pennsylvania 19102	125
James C. Butterfield, Inc.	297 West Michigan Avenue Jackson, Michigan 49201	30
Buttonwood Corporation	4051 Penobscot Bldg. Detroit, Michigan 48226	30
Cogan, Berlind, Weill & Levitt, Inc.	767 Fifth Avenue New York, N.Y. 10022	125
Devon Securities	60 East 56th Street New York, N.Y. 10022	30
Edwards & Hanley Securities, Inc.	55 Broad Street New York, N.Y. 10004	30
Emanuel, Deetjen & Co.	120 Broadway New York, N.Y. 10005	30
First of Michigan Corporation	Buhl Building Detroit, Michigan 48226	125
First Mid America Corporation	1001 "O" Street Lincoln, Nebraska 68501	30
Freehling & Co.	120 South LaSalle Street Chicago, Illinois 60603	50

H. Hentz & Co.	72 Wall Street New York, N.Y. 10005	125
Hertz, Warner & Co.	Two Broadway New York, New York 10004	30
Herzfeld & Stern	30 Broad Street New York, N.Y. 10004	50
Hirsch & Co.	25 Broad Street New York, New York 10004	125
JEN Securities, Inc.	26635 Woodward Avenue Huntington Woods, Michigan 48070	30
Kamen & Company	50 Broadway New York, New York 10004	30
Kenower, MacArthur & Co.	Ford Building Detroit, Michigan 48226	30
Kohlmeyer & Co.	147 Carondelet Street New Orleans, Louisiana 70130	125
Manley, Bennett, McDonald & Co.	1100 Buhl Building Detroit, Michigan 48226	30
Mason & Lee, Inc.	Corner 8th & Church Streets Lynchburg, Virginia 24505	30
McKinney, Rose & Company, Inc.	Mercantile Bank Building Dallas, Texas 75201	50
Parker, Bishop & Welsh, Inc.	100 Park Avenue Oklahoma City, Oklahoma 73102	30
Rauscher Pierce & Co., Inc.	1200 Mercantile Dallas Building Dallas, Texas 75201	125
Roberts, Scott & Co., Inc.	First National Bank Building San Diego, California 92101	50
The Robinson-Humphrey Company, Inc.	Two Peachtree Street, N.W. Atlanta, Georgia 30303	125
Rosenthal & Co.	40 Wall Street New York, New York 10005	50
Russ & Company, Inc.	Alamo National Bldg. San Antonio, Texas 78205	30
Sanders & Company, Inc.	830 Republic National Bank Bldg. Dallas, Texas 75201	50
Schneider, Bernet & Hickman Securities Corporation	3200 First National Bank Building Dallas, Texas 75202	125
Joseph Sebag Incorporated	523 West Sixth Street Los Angeles, California 90014	30
Underwood, Neuhaus & Co. Incorporated	724 Travis Houston, Texas 77002	125

Weber, Hall, Cobb & Caudle, Inc. . .	1800 LTV Tower Bldg. Dallas, Texas 75201	50
Zuckerman, Smith & Co.	30 Broad Street New York, N.Y. 10004	50
		3,300

The Representative of the Underwriters has advised that sales to certain dealers may be made at concessions of $70 per Unit and that the Underwriters may allow, and such dealers may reallow, discounts of $25 per Unit on sales to certain other dealers. The public offering price and the concession and re-allowance may be changed after the initial public offering.

The Company has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

The Company has agreed to issue to Ladenburg, Thalmann & Co., the Representative of the Underwriters, in its individual capacity, a warrant exercisable between the first and fifth anniversary dates of the sale of the Units offered hereby to the Underwriters, to purchase 23,000 shares of Common Stock at $4.00 per share. The warrant is transferable only among the partners and employees of Ladenburg, Thalmann & Co. The warrant contains provisions designed to protect against dilution through stock dividends, splits and distributions, recapitalizations, mergers, consolidations and similar transactions. The Company has agreed that, if requested by Ladenburg, Thalmann & Co., it will, at its expense, under certain conditions, file two Post-Effective Amendments to the Registration Statement of which this Prospectus forms a part covering all or any of the shares of Common Stock issuable upon the exercise of such warrant and that it will include all or any of such shares as part of any registration

statement which the Company may file other than at the request of Ladenburg, Thalmann & Co.

The Company has also agreed to pay to the Representative of the Underwriters a non-accountable expense allowance of $25,000 for out-of-pocket expenses incurred in connection with this offering, including fees and expenses of counsel, other than in connection with the Indenture and other than Blue Sky expenses, both of which the Company will be required to pay.

In connection with this offering, the Company previously entered into a letter agreement with Graham Loving & Co., a proposed Selected Dealer in this offering, for underwriting the securities offered hereby. This agreement was subsequently terminated by the parties and in connection therewith the Company paid Graham Loving & Co. and its counsel a total of $11,000 in reimbursement of expenses and fees theretofore incurred. In addition the parent of the Company, American Raceways Inc., paid Graham Loving & Co. $65,000 for investment banking services rendered by such firm to American Raceways Inc. in connection with previous private placements of securities of American Raceways Inc. and $5,000 in consideration of the release by Graham Loving & Co. of its first right of refusal on future financings of American Raceways Inc. and its right to designate nominees to the Board of Directors of American Raceways Inc. The Underwriters have agreed to allocate to Graham Loving & Co., as a Selected Dealer, a selling group participation in this offering of 440 Units, and Ladenburg, Thalmann & Co. has agreed to pay, out of its fee for managing this offering, the sum of $44,000 to Graham Loving & Co. as a finder's fee.

Graham Loving & Co. has purchased 10,000 shares of

the Common Stock as described on the cover page hereof. These shares may not be sold or otherwise disposed of by Graham Loving & Co. for one year after the effective date of the Registration Statement filed in connection with this offering.

LEGAL OPINIONS

Legal matters in connection with the securities offered hereby will be passed upon for the Company by Messrs. Witts, Lee, Pletcher & Douglass, 1000 Empire Life Bldg., Dallas, Texas 75201 and Messrs. Scholl, Jenkins, Robinson & Stieg, 1051 Penobscot Building, Detroit, Michigan 48226; and for the Underwriters by Messrs. Rosenman Colin Kaye Petschek Freund & Emil, 575 Madison Avenue New York, New York 10022.

EXPERTS

The financial statements included herein and in the Registration Statement have been examined by Messrs. Herman & MacLean, certified public accountants, 3361 Penobscot Building, Detroit, Michigan 48226, whose opinion thereon appears elsewhere herein, and are included herein in reliance on the opinion of such firm and on the authority of such firm as experts in auditing and accounting.

The material set forth in the penultimate paragraph under the caption "Use of Proceeds" herein and in the fourth paragraph under the caption "Plant and Property" herein, insofar as it relates to Spencer Buchanan & Associates, Inc., has been included herein in reliance on the opinion of said corporation and on the authority of said corporation as experts in engineering.

TRANSFER AGENT

The Transfer Agent for the Common Stock is National Bank of Commerce of Dallas (of Dallas, Texas).

ANNUAL REPORTS

The Company intends to furnish to its stockholders annual reports containing financial statements certified by independent public accountants. The Company will also publish quarterly statements of earnings, except with respect to the last quarter of each year.

REGISTRATION STATEMENT

Texas International Speedway, Inc. has filed with the Securities and Exchange Commission, Washington, D.C. 20549, a Registration Statement (herein together with all amendments thereto, called the "Registration Statement") under the Securities Act of 1933, as amended, with respect to the 330,000 shares of Common Stock and $3,300,000 of Debentures offered by this Prospectus, the 23,000 shares of Common Stock issuable upon exercise of the Warrant issued to the Representative of the Underwriter and the 10,000 shares thereof heretofore purchased by Graham Loving & Co., a proposed Selected Dealer in this offering. This Prospectus does not contain all of the information set forth in the Registration Statement, and for further information with respect to Texas International Speedway, Inc., the Common Stock and the Debentures offered hereby, reference is made to the Registration Statement, including the exhibits which are a part thereof.

OPINION OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Texas International Speedway, Inc.
Detroit, Michigan

We have examined the balance sheet of Texas International Speedway, Inc. (a Texas corporation) as of May 31, 1969 and the related statement of cash receipts and disbursements for the period from date of incorporation on January 13, 1969 to May 31, 1969. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Texas International Speedway, Inc. at May 31, 1969 and the related cash receipts and disbursements for the period referred to above, in conformity with generally accepted accounting principles.

We have reviewed the pro forma balance sheet as of May 31, 1969 of Texas International Speedway, Inc. In our opinion, such pro forma balance sheet presents fairly the financial position of Texas International Speedway, Inc. as of May 31, 1969, in conformity with generally accepted accounting principles after giving effect to the pro forma transactions set forth thereon.

HERMAN & MacLEAN
Certified Public Accountants

Detroit, Michigan
October 27, 1969

TEXAS INTERNATIONAL SPEEDWAY, INC.
(a Texas corporation)

(a Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

BALANCE SHEETS

ASSETS

	May 31, 1969 (Audited)	August 31, 1969 (Unaudited)
Current assets:		
Cash in banks	$268,099	$75,864
Stock subscriptions receivable – Note A	598,500	36,000
Accounts receivable	1,240	1,390
Racing Sanction costs – Note B	17,500	35,000
Deferred current race expenses		67,830
Total current assets	$885,339	$216,084
Property, plant and equipment, at cost – Note C:		
Real estate	1,119,120	1,119,120
Racing plant construction in progress	610,056	2,699,187
Equipment	7,759	8,679
Engineering services	79,039	153,460
Deferred promotional and development costs – Note D:		
Allocated executive office overhead – Note G	38,730	70,744
Promotional	20,344	33,998
Other general administrative expenses	48,221	92,928
Deferred offering expenses – Note E	750	8,213
Deferred organization expenses	1,934	1,934
Racing sanction costs, less current portion – Note B	332,500	315,000
	$3,143,792	$4,719,347

LIABILITIES

Current liabilities:		
Note payable to bank – Note G		$350,000
Note payable to American Raceways Inc. – Note C		285,000
Current portion of long-term secured debt – Note C	$111,989	111,989
Current portion of liability for racing sanctions – Note B	25,000	37,500
Accounts payable – American Raceways Inc.	132,665	93,925
Accounts payable – other	429,878	1,367,722
Accrued expenses	13,526	33,949
Deferred revenues – advance ticket sales		21,028
Total current liabilities	$713,058	$2,301,113
Long-term secured debt, less current portion – Note C	905,234	905,234
Liability for racing sanctions, less current portion – Note B	225,000	212,500
Total liabilities	$1,843,292	$3,418,847
Contingent liabilities and commitments – Note G		

SHAREHOLDERS' EQUITY

Capital stock, common, par value $1 per share; authorized 2,500,000 shares; issued and outstanding 234,000 shares at May 31, 1969 and 421,500 shares at August 31, 1969 – Note H	$234,000	$421,500
Additional paid-in capital – Note I	468,000	843,000
Subscriptions for unissued common stock, 199,500 shares at May 31, 1969 and 12,000 shares at August 31, 1969 – Notes A and H	598,500	36,000
	$1,300,500	$1,300,500
	$3,143,792	$4,719,347

The attached notes to financial statements are an integral part of this statement.

TEXAS INTERNATIONAL SPEEDWAY, INC.
(a Texas corporation)

(a Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

STATEMENTS OF CASH RECEIPTS AND DISBURSEMENTS

	January 13, 1969 to May 31, 1969 (Audited)	January 13, 1969 to August 31, 1969 (Unaudited)
Cash in banks, beginning of period	None	None
Receipts:		
Sale of stock	$702,000	$1,264,500
Loan from American Raceways Inc.		285,000
Advances from American Raceways Inc.	2,000	457,530
Loans from bank		700,000
Advance ticket sales		21,028
Miscellaneous	120	253
Total receipts	$704,120	$2,728,311
Disbursements:		
Advances	$1,358	$1,358
Payment on racing sanction costs	100,000	100,000
Payments for deferred current race expenses		32,780
Property, plant and equipment:		
Real estate	100,522	101,522
Site preparation	132,674	1,054,571
Grandstand		121,257
Water mains and wells	2,173	2,632
Walls and safety fences		62,507
Buildings		61,693
Electrical and plumbing		23,328
Miscellaneous construction costs	4,776	75,653
Equipment	2,864	7,759
Engineering services	26,617	100,250
Deferred promotional and development costs:		
Allocated executive office overhead	33,605	48,966
Promotional	18,858	25,213
Other general administrative expenses	10,640	51,138
Deferred offering expenses		4,886
Deferred organization expenses	1,934	1,934
Payment of bank loan		350,000
Payments of advances from American Raceways Inc.		425,000
Total disbursements	$436,021	$2,652,447
Cash in banks, end of period	$268,099	$75,864

Disbursements shown above for the period from January 13, 1969 to May 31, 1969 include reimbursement to American Raceway Inc. for $393,754 of direct charges made by American Raceways Inc. on behalf of the Company and $33,605 of allocated executive office overhead.

Disbursements shown above for the period from January 13, 1969 to August 31, 1969 include reimbursement to American Raceways Inc. for $1,405,368 of direct charges made by American Raceways Inc. on behalf of the Company and $48,966 of allocated executive office overhead and are unaudited.

The attached notes to financial statements are an integral part of this statement.

TEXAS INTERNATIONAL SPEEDWAY, INC.
(a Texas corporation)

(a Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

PRO FORMA BALANCE SHEET – May 31, 1969

(BASED UPON SALE OF $3,300,000 OF PARTICIPATING SUBORDINATED DEBENTURES AND 330,000 SHARES OF COMMON STOCK AND ESTIMATED USE OF PROCEEDS DERIVED THEREFROM)

ASSETS

	Historical Balance Sheet		Pro Forma Transactions (Note below)	Pro Forma Balance Sheet
Current assets:				
		(1)	$598,500	
		(2)	4,398,900	
Cash in banks	$268,099	(3)	(560,915)	$93,870
		(4)	1,240	
		(5)	(4,611,954)	
Stock subscriptions receivable – Note A	$98,500	(1)	(598,500)	
Accounts receivable	1,240	(4)	(1,240)	
Racing sanction costs – Note B	17,500			17,500
Total current assets	$885,339			$111,370
Property, plant and equipment, at cost – Note C:				
Real estate	1,119,120			1,119,120
Racing plant construction in progress	610,056			610,056
Equipment	7,759			7,759
Engineering services	79,039			79,039
Funds to be used for racing plant		(5)	3,678,364	3,678,364
Deferred promotional and development costs – Note D:				
Allocated executive overhead – Note G	38,730			38,730
Promotional	20,344			20,344
Other general administrative expenses	48,221			48,221
Funds to be used for general administrative expenses		(5)	295,771	295,771
Deferred offering expenses – Note E	750	(3)	(750)	
Deferred organization expenses	1,934			1,934
Deferred debenture discount and expense – Note E		(3)	420,686	420,686
Racing sanction costs, less current portion – Note B	332,500			332,500
	$3,143,792			$6,763,894

Note – Pro forma transactions given effect to above:

(1) Collection of stock subscriptions receivable.

(2) Sale of $3,300,000 of 8% Participating Subor-

dinated Debentures and 330,000 shares of Common Stock to Underwriters for the aggregate amount of $4,398,900 before payment of underwriters' discount, etc. as set forth in next note.

The attached notes to financial statements are an integral part of this statement.

TEXAS INTERNATIONAL SPEEDWAY, INC.
(a Texas corporation)

(a Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

PRO FORMA BALANCE SHEET – May 31, 1969

(BASED UPON SALE OF $3,300,000 OF PARTICIPATING SUBORDINATED DEBENTURES AND 330,000 SHARES OF COMMON STOCK AND ESTIMATED USE OF PROCEEDS DERIVED THEREFROM)

LIABILITIES

	Historical Balance Sheet		Pro Forma Transactions (Note below)	Pro Forma Balance Sheet
Current liabilities:				
Current portion of long-term secured debt – Notes C and F	$111,989	(5)	$(50,000)	$61,989
Current portion of liability for racing sanctions – Notes B and F	25,000	(5)	(12,500)	12,500
Accounts payable – American Raceways Inc.	132,665	(5)	(132,665)	
Accounts payable – other	429,878	(5)	(429,128)	
		(3)	(750)	
Accrued expenses	13,526	(3)	(13,526)	
Total current liabilities	$713,058			$74,489
Long-term secured debt, less current portion – Notes C and F	905,234			905,234
Liability for racing sanctions, less current portion – Notes B and F	225,000			225,000
Participating subordinated debentures payable – Notes F and G		(2)	3,330,000	3,300,000
Total liabilities	$1,843,292			$4,504,723
Contingent liabilities and commitments – Note G				

SHAREHOLDERS' EQUITY

Capital stock, common par value $1 per share; authorized 2,500,000 shares; issued and outstanding 234,000 shares (pro forma 763,500 shares) – Note H		(1)	199,500	
	$234,000	(2)	330,000	$763,500
		(1)	399,000	
Additional paid-in capital – Notes E and I	468,000	(2)	768,900	1,495,671
		(3)	(140,229)	
Subscriptions for unissued common stock, 199,500 shares – Notes A and H	598,500	(1)	(598,500)	
	$1,300,500			$2,259,171
	$3,143,792			$6,763,894

(3) Payment of underwriters' discount, commissions and expenses in the amount of $420,915 and estimated offering expenses of $140,000 (of which $750 is included in the Historical Balance Sheet).

(4) Collection of accounts receivable.

(5) Expenditure of funds for secured debt payment, estimated construction costs, estimated expenses to opening date, etc.

The attached notes to financial statements are an integral part of this statement.

TEXAS INTERNATIONAL SPEEDWAY, INC.
(a Texas corporation)

(a Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

NOTES TO FINANCIAL STATEMENTS

(The notes that are applicable to the unaudited August 31, 1969 balance sheet and the unaudited statement of cash receipts and disbursements for the period from January 13, 1969 to August 31, 1969 are not covered by the opinion of the independent certified public accountants)

Note A – From June 1, 1969 to August 31, 1969, the Company has collected $562,500 on stock subscriptions outstanding at May 31, 1969 and has issued 187,500 of its common shares in accordance therewith. Since August 31, 1969, the Company has collected $36,000 on stock subscriptions outstanding at May 31, 1969 and August 31, 1969 and has issued 12,000 of its common shares in accordance therewith.

Note B – The Company has entered into an agreement with the National Association for Stock Car Auto Racing, Inc. to conduct two sanctioned "Grand National" automobile races annually for ten years beginning in December of 1969. The total cost of the sanctions acquired is $350,000 of which $100,000 has been paid prior to June 1, 1969. In addition, the Company has paid $12,500 in September, 1969 and the balance is payable in semi-annual payments of $12,500 each. Racing sanction costs will be amortized over the ten years at the rate of $17,500 per sanctioned race.

Note C – Note payable to bank at August 31, 1969 is unsecured, bears interest at the rate of 9½% per annum

and was due October 20, 1969. The Company has not made payment nor has the bank demanded payment.

Note payable to American Raceways Inc. at August 31, 1969 is unsecured, bears interest at the rate of 9½ per annum and is payable on demand.

Long-term secured debt at May 31, 1969 and August 31, 1969 is summarized below:

	Current	Long-Term
Promissory notes secured by all of the real estate:		
Due in annual instalments of $61,989 plus interest at 6% from 1970 to 1979	$61,989	$557,904
Due November 10, 1969 – $50,000; balance due in annual instalments of $69,466 plus interest at 6% from 1970 to 1974	50,000	347,330
	$111,989	$905,234

Note D – The Company has had no operations to date and has deferred all promotional and development costs incurred through May 31, 1969 and August 31, 1969. The Company intends to amortize these costs over five years on a straight-line basis upon the commencement of racing operations.

Note E – Underwriters' discount, commissions and expenses and offering expenses are to be allocated to deferred debenture discount and expense and additional paid-in capital in proportion to the amounts received from the sale of Participating Subordinated Debentures and Common Stock offered in this Prospectus. Deferred debenture discount and expense is to be amortized over the term of the debentures.

Note F – The aggregate amount of maturities on a pro forma basis of long-term secured debt, racing sanction liability and Participating Subordinated Debentures for

each of the five years following May 31, 1969 is summarized below:

Year ending May 31,	Amount
1970	$136,989
1971	156,455
1972	156,455
1973	156,455
1974	431,455

The annual interest accrual scheduled on a pro forma basis for the first full year on the long-term secured debt amounts to $59,554 and on the Participating Subordinated Debentures amounts to $264,000.

Note G – The Company has entered into both fixed and unit price contracts with several contractors and others covering acquisition of the real estate, the clearing, grading and excavation of the site, construction of fences, safety and pit walls, the grandstand, certain miscellaneous buildings and other services. The aggregate amount of unit price and other contracts where the work has been completed and invoiced and fixed price contracts approximates $6,000,000 of which $2,275,203 is included on the historical balance sheet at May 31, 1969 and $4,530,050 at August 31, 1969.

The Company has entered into a Management Agreement with American Raceways Inc. under the terms of which American Raceways Inc. is furnishing executive and administrative management to the Company and other technical advice and assistance in the construction and placing in operation of its track. The Company will reimburse American Raceways Inc. for 25% of American's executive office overhead, which includes salaries of the executive officers, other managerial salararies, rent, ad-

ministrative clerical salaries and secretarial salaries (other than General Manager's salary) for the period December 1, 1968 to November 30, 1969. The Company will also, within 60 days after commencing operations, pay to American Raceways Inc. a sum equal to 50% of the excess, if any, of the pre-operating expenses incurred by American Raceways Inc. over the pre-operating expenses incurred by the Company. For this purpose, pre-operating expenses represent executive office overhead (as described above) and promotional and other administrative expenses (exclusive of such things as interest charges, transfer agent fees, etc.) from date of incorporation to the date of commencement of operations. The pre-operating expenses incurred by American Raceways Inc. amounted to $400,711.

In addition, the Company has agreed to pay a fee of $100,000 to American Raceways Inc. of which $70,000 has been paid during the three months ended August 31, 1969, $20,000 since August 31, 1969 and the balance of $10,000 is payable on the 15th day of November, 1969 to reimburse American Raceways, Inc. for the use of its construction plans and for technical advice to the Company during the construction of its facilities.

From December 1, 1969 until November 30, 1970, the Company will pay to American Raceways Inc. under the terms of the Management Agreement that proportion of the executive office overhead which the gross revenues of the Company bear to the gross revenues of all tracks to which American Raceways Inc. supplies executive and administrative management but not more than $75,000 per year.

The reimbursement for executive office overhead to May 31, 1969 and August 31, 1969 and the fee of $100,000 for the use of construction plans and for technical advice

have been included in the accompanying financial statements.

Two individuals have claimed a fee from American Raceways Inc., formerly Michigan International Speedway, Inc., for alleged services in introducing the officers of the Company to the sellers of the Company's real estate. Any possible liability in connection with this claim has been assumed by the Company. These individuals have instituted suit against the Company for the sum of $250,000 alleging a breach of contractual obligations arising from alleged services performed by them and expenses incurred by them in connection therewith on behalf of the Company. No specifications have been made of the nature or amounts of such services or expenses. The Company denies any liability in this regard and in the opinion of legal counsel for the Company, any possible recovery by such individuals from the Company would not exceed the amount of $56,000.

During October 1969, the Company was advised by counsel for Texas International Raceway, Inc., a Texas corporation, that they deemed the name of the Company to be so similar to its name as to be deceptive and misleading and that they had prior claim because of prior usage. They have threatened to institute legal action if the Company does not immediately cease to use the name Texas International Speedway, Inc. In the opinion of counsel for the Company, the claim is without merit.

See "Description of Debentures" for the terms and conditions of the Debentures being offered in this Prospectus.

Note H – The Company has granted an option to a contractor to purchase 8,000 shares of its Common Stock at a price of $3 per share at any time within five years after June 10, 1969, providing the contractor fully completes

the race track in such condition as to pass the inspections of the Sports Car Club of America and the National Association for Stock Car Auto Racing, Inc. on or before October 24, 1969. The Company is of the opinion that the race track was in such condition as to satisfy the terms of the option agreement. The Company has reserved 8,000 shares of its Common Stock for possible issuance in connection with this option.

In connection with the offering made in this Prospectus, the Company has agreed to issue to Ladenburg, Thalmann & Co. a warrant to purchase 23,000 shares of the Company's Common Stock at a price of $4 per share exercisable between the first and fifth anniversary dates of the closing date for the sale of the Units offered by this Prospectus. The Company has agreed to reserve 23,000 shares of its Common Stock for issuance upon exercise of these warrants.

All of the shares of Common Stock outstanding were issued for cash at a price of $3 per share.

See "Redemption and Sinking Fund Provisions," "Restrictions on Dividends and Acquisition of Stock" and "Voting Rights" under the caption "Description of Debentures" for information regarding the Income Participation Premium upon maturity or redemption of the Debentures, limitations on payment of dividends, acquisition of the Company's Common Stock and Common Stock voting rights that will be imposed by the Indenture under which the Debentures being offered herein will be issued.

Note I – At May 31, 1969 and August 31, 1969, additional paid-in capital consisted of the following:

	May 31, 1969	August 31, 1969
Proceeds of sale of 234,000 shares of Common Stock as of May 31, 1969 and 421,500 shares of Common Stock as of August 31, 1969	$702,000	$1,264,500
Less: Par value of shares issued	234,000	421,500
	$468,000	$843,000

Note J – During the three months ended August 31, 1969 the Company has borrowed $285,000 from American Raceways Inc. and $700,000 from a bank and repaid $350,000 to that bank. Since August 31, 1969, the Company has repaid $25,000 to American Raceways Inc. on the note and borrowed an additional sum of $850,000 from the same bank. The note for $850,000 is unsecured by the Company, bears interest at the rate of 9½% per annum and is payable on demand, but if not meanwhile demanded, is due December 9, 1969. See Note C for the terms of the other notes which were outstanding at August 31, 1969.

Texas International Speedway, Inc.

(A Subsidiary of American Raceways Inc., formerly Michigan International Speedway, Inc.)

3,300 Units

$3,330,000
8% Participating
Subordinated Debentures
due October 15, 1984

330,000 Shares

Common Stock
($1.00 par value)

Subscription Price
$1,333 per Unit

LADENBURG, THALMANN & CO.

PROSPECTUS

Dated October 30, 1969

TEXAS INTERNATIONAL SPEEDWAY, INC.

Supplement to Prospectus dated October 30, 1969

On November 3, 1969 the National Association for Stock Car Auto Racing, Inc. (NASCAR) issued its sanction agreement for the Grand National Stock Car Race scheduled to be held at the Company's facility on December 7, 1969. The Company will pay a prize of $75,000 and a sanction fee of $11,525 for this race. (See paragraph 6 under caption "Introductory Statement" and sub-captions "Sanctions" and "Prizes" under caption "History and Business" herein.)

On November 9, 1969 the Company held its scheduled Canadian-American Challenge Cup Race. The gross receipts from this race were approximately $125,000 to $150,000. (See sub-caption "Sources of Revenue" under caption "History and Business" herein.)

November 12, 1969.

TEXAS INTERNATIONAL SPEEDWAY, INC.

Supplement to Prospectus dated October 30, 1969

On November 3, 1969, the National Association for Stock Car Auto Racing, Inc. (NASCAR) issued a sanction agreement for the Grand National Stock Car Race scheduled to be held at the Company's facility on December 7, 1969, and the race was held on that date. The Company paid a prize of $75,000 and a sanction fee of $11,525 for this race. Gross receipts from this race were approximately $150,000 to $200,000. (See paragraph 6 under caption "Introductory Statement" and subcaptions "Sanctions," "Prizes" and "Sources of Revenues" under "History and Business" herein.)

On November 9, 1969 the Company held its scheduled Canadian-American Challenge Cup Race. The Company paid a prize of $60,000 and a sanction fee of $7,250. The gross receipts from this race were approximately $125,000. (See sub-captions "Sanctions", "Prizes" and "Sources of Revenue" under caption "History and Business" herein.)

December 23, 1969.

EXHIBIT Px-2 – PROOF OF CLAIM OF RALPH E. HUDDLESTON

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, et al.,	:	Civil Action No. 3-6677-C
Plaintiffs,	:	PROOF OF CLAIM
vs.	:	FOR ELIGIBLE CLAIMANTS
LADENBURG, THALMANN & CO., et al.,	:	
Defendants.	:	

INSTRUCTIONS AND INFORMATION

This Proof of Claim must be submitted by each eligible claimant as defined below in order to receive a cash distribution from approximately $175,000 of funds that are available to be paid to the named plaintiffs and members of the class as a result of a partial settlement described in the Notice of Pendency of Class Action and Settlement Hearing previously communicated to the named plaintiffs and all potential members of the class in the above captioned action.

1. You must be either a named plaintiff in the above captioned action or a person who purchased securities of Texas International Speedway, Inc. (hereinafter "T.I.S.") in the form of "Units", common stock and/or debentures either at the effective date of the original public offering on October 30, 1969 or in the public market during the

period from October 30, 1969 through January 28, 1970 and suffered a net loss from the subsequent sale or failure to sell such securities prior to the bankruptcy of T.I.S. in December, 1970.

2. Excluded from the above definition of eligible claimants is any person named as a defendant in this class action or any person who was a director, officer, partner or managerial employee of any of the named defendants during a one-year period prior to January 28, 1970. However, you can still submit a claim if you are an eligible claimant and the securities of T.I.S. owned by you were only held in "street name" by one of the named defendants. Please see Exhibit "A" attached to the Notice of General Information With Regard to Filing Proof of Claim to Participate in the Partial Settlement (hereinafter referred to as "Notice of General Information") for a listing of the named defendants in this class action.

3. You must attach to this Proof of Claim copies of broker's confirmations of sale or purchase of securities of T.I.S. reflecting such transactions, monthly statements, or other secondary documents evidencing each of your purchases and sales and your present holdings of securities of T.I.S. (For information as to the type of secondary documentation that is accepted, please see Notice of General Information.)

4. For the purpose of calculating your claim, any securities of T.I.S. purchased by a named plaintiff or by a member of the class during the defined period are deemed to be worth zero and thus will be treated as a sale for purpose of calculating your loss. You must include as part of the cost of each purchase and the expense of each sale, commissions and taxes paid, if any. Your net loss is arrived at by deducting any profit realized from the sale of

securities of T.I.S. purchased during the defined period and sold either during the defined period or anytime thereafter. Thus, the loss you can claim if you have made both purchases and sales should be a net figure.

5. For your information, the securities of T.I.S. were originally sold at a public offering on October 30, 1969. They were initially offered only in "Units" valued at $1,333.00 consisting of $1,000.00 principal amount of debentures and 100 shares of common stock valued at $3.33 per share. The certificates representing the debentures and the shares representing the common stock, however, were able to be traded separately immediately after the public offering.

6. You must execute this Proof of Claim before a notary public. If you are a partnership, please indicate that you sign as a general partner. If you are a corporation, please have a duly authorized officer sign and indicate his or her office. If you are a legal representative of the eligible claimant, please indicate your capacity and attach written authorizations in the form of corporate resolution, letters of administration, etc.

7. *You must file this Proof of Claim no later than the 31st day of December, 1978 with Robert H. Jaffe, Esq., of Robert H. Jaffe, P.A., 8 Mountain Avenue, Springfield, New Jersey, 07081.* This Proof of Claim shall be deemed filed when placed in a United States mail box, postage prepaid, or if otherwise filed, when it is actually received by the office of Robert H. Jaffe, P.A.

PROOF OF CLAIM
OF ELIGIBLE CLAIMANT

STATE OF :

: ss.

COUNTY OF :

DECLARATION OF CLAIMANT: The undersigned hereby declares he, she or it is either the person or a legal representative of the person who meets the requirements set forth in the above Instructions and Information section to be an eligible claimant to participate in the cash distribution from the partial settlement of this class action.

The undersigned further declares he, she or it is not a named defendant in the above captioned class action or any person who was a director, executive officer, or general partner of any of the named defendants during the one-year period prior to January 28, 1970.

PURCHASES: At the time of the original offering of securities of T.I.S. or during the period from October 30, 1969 through January 28, 1970, the undersigned purchased:

(a) Common Stock of T.I.S. as follows:

Date of Purchase	No. of Shares	Price per Share	Gross Purchase Cost including commissions and taxes, if any
11-4-69	200	9	$1,832.80

(b) Debentures of T.I.S. as follows:

Date of Purchase	No. of Debentures	Price per Debenture	Gross Purchase Cost including commissions and taxes, if any
11-12-69	2000	$600.00	$1,225.12

(c) Units of T.I.S. securities as follows:

Date of Purchase	No of Units	Price per Unit	Gross Purchase Cost including commissions and taxes, if any
10-31-69	1	$1,330.00	$1,334.89

SALES: Since October 30, 1969 to the date of this Proof of Claim, the undersigned has sold:

(a) Common Stock of T.I.S. as follows:

Date of Sale	Date of Purchase	Gross Sales Price	Gross Purchase Cost	No. of Shares	Net Sales Proceeds
11-10-69	11-4-69	$1,082.	916.00	100	$166.00
3-30-70	11-4-69	$309.00	916.00	100	-<607.00>

(b) Debentures of T.I.S. as follows:

Date of Sale	Date of Purchase	Gross Sales Price	Gross Purchase Cost	No. of Debentures	Net Sales Proceeds

(c) Units of T.I.S. securities as follows:

Date of Sale	Date of Purchase	Gross Sales Price	Gross Purchase Cost	No. of Units	Net Sales Proceeds

(Please see note at head of next page respecting continuation of schedules, if necessary.)

IF YOU MADE MORE THAN THREE SALES OR PURCHASES OF ONE OR MORE OF THE ABOVE DESCRIBED SECURITIES OF T.I.S., PLEASE CONTINUE THE APPROPRIATE SCHEDULE OR SCHEDULES USING THE SAME HEADINGS AS ABOVE ON AN ADDITIONAL SHEET OF PAPER AND ATTACH IT TO THIS PROOF OF CLAIM.

HOLDINGS: With respect to the securities of T.I.S. which the undersigned purchased either at the original public offering effective October 30, 1969 or during the period October 30, 1969 through January 28, 1970 and which have been identified in the "Purchases" section of this Proof of Claim, the undersigned is presently the owner of:

____ shares of common stock which have a net cost basis today of $ ____;

2 debentures in the total principal face amount of $2000.00, having a net cost basis today of $1,225.12;

OR 1 Units having a net cost basis today of $1,334.89.

REIMBURSEMENT OF LITIGATION COSTS: The undersigned has contributed the sum of $578.06 towards the prosecution and/or maintenance of this class action for which reimbursement is sought as part of this Proof of Claim.

Based upon the above, and pursuant to the Instructions and Information section set forth at the head of this Proof of Claim and in the Notice of General Information, the undersigned hereby claims a net loss of $3,001.01 on the above identified purchases and sales made of securities of T.I.S. Attached to this Proof of Claim you will find all documentation necessary to evidence the purchase and sales claimed.

The undersigned or the legal representative of the undersigned swears that the foregoing statements are true, correct and complete.

/s/ Ralph E. Huddleston
Signature of Claimant
or Legal Representative

Sworn and subscribed to before me
this 12 day of February, 1979.
/s/ _____
Notary Public in and for the County
of Dallas, State of Texas
Term expires Dec 11, 1980

RAUSCHER PIERCE SECURITIES CORPORATION

Member New York Stock Exchange
American Stock Exchange Midwest Stock Exchange

AFFILIATE
RAUSCHER PIERCE & CO., INC.

| | | |

AFFILIATE
RAUSCHER PIERCE & CO., INC.

	100	TEXAS INTL SPEEDWAY		11		11	10	69	5	1	P	11	18	19

RETURN SECOND COPY WITH YOUR PAYMENT OR SECURITIES TO THE OFFICE SERVICING YOUR ACCOUNT AND RETAIN THE ORIGINAL FOR YOUR RECORDS AND TAX PURPOSES.

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RALPH E HUDDLESTON
1810 NORTH FITZHUGH
DALLAS TEXAS 75206

D

Thank You . . . for letting us serve you. Account due or securities must be received at our office on or before settlement date shown. Otherwise, you will be obligated for interest and other charges that may appear on this transaction.

Sincerely,
RAUSCHER PIERCE SECURITIES CORPORATION

CONFIRMATION AND STATEMENT — CUSTOMER COPY

RAUSCHER PIERCE SECURITIES CORPORATION

Offices Throughout The Southwest

Member New York Stock Exchange
Associate Stock Exchange Midwest Stock Exchange

AFFILIATE
RAUSCHER PIERCE & CO., INC.

	100	TEXAS INTL SPEEDWAY		3.09		03	30	70	9	1	T	04	06	19

RETURN SECOND COPY WITH YOUR PAYMENT OR SECURITIES TO THE OFFICE SERVICING YOUR ACCOUNT AND RETAIN THE ORIGINAL FOR YOUR RECORDS AND TAX PURPOSES.

50	392669	1	30	5424		309	00									309	

RALPH E HUDDLESTON
1810 NORTH FITZHUGH
DALLAS TEXAS 75206

31-C

Thank You . . . for letting us serve you. Account due or securities must be received at our office on or before settlement date shown. Otherwise, you will be obligated for interest and other charges that may appear on this transaction.

Sincerely,
RAUSCHER PIERCE SECURITIES CORPORATION

CONFIRMATION AND STATEMENT — CUSTOMER COPY

240a

EXHIBIT Px-4 – PROOF OF CLAIM OF CHESTER E. BRADLEY, JR.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

DAVID M. KEMP, et al.,	)
Plaintiffs,	)
	)
vs.	)
	)
LADENBURG, THALMANN & CO., et al.,	)
Defendants.	)

INSTRUCTIONS AND INFORMATION

This Proof of Claim must be submitted by each eligible claimant as defined below in order to receive a cash distribution from approximately $175,000 of funds that are available to be paid to the named plaintiffs and members of the class as a result of a partial settlement described in the Notice of Pendency of Class Action and Settlement Hearing previously communicated to the named plaintiffs and all potential members of the class in the above captioned action.

1. You must be either a named plaintiff in the above captioned action or a person who purchased securities of Texas International Speedway, Inc. (hereinafter "T.I.S.") in the form of "Units", common stock and/or debentures either at the effective date of the original public offering

on October 30, 1969 or in the public market during the period from October 30, 1969 through January 28, 1970 and suffered a net loss from the subsequent sale or failure to sell such securities prior to the bankruptcy of T.I.S. in December, 1970.

2. Excluded from the above definition of eligible claimants is any person named as a defendant in this class action or any person who was a director, officer, partner or managerial employee of any of the named defendants during a one-year period prior to January 28, 1970. However, you can still submit a claim if you are an eligible claimant and the securities of T.I.S. owned by you were only held in "street name" by one of the named defendants. Please see Exhibit "A" attached to the Notice of General Information With Regard to Filing Proof of Claim to Participate in the Partial Settlement (hereinafter referred to as "Notice of General Information") for a listing of the named defendants in this class action.

3. You must attach to this Proof of Claim copies of broker's confirmations of sale or purchase of securities of T.I.S. reflecting such transactions, monthly statements, or other secondary documents evidencing each of your purchases and sales and your present holdings of securities of T.I.S. (For information as to the type of secondary documentation that is accepted, please see Notice of General Information.)

4. For the purpose of calculating your claim, any securities of T.I.S. purchased by a named plaintiff or by a member of the class during the defined period are deemed to be worth zero and thus will be treated as a sale for purpose of calculating your loss. You must include as part of the cost of each purchase and the expense of each sale, commissions and taxes paid, if any. Your net loss is arriv-

ed at by deducting any profit realized from the sale of securities of T.I.S. purchased during the defined period and sold either during the defined period or anytime thereafter. Thus, the loss you can claim if you have made both purchases and sales should be a net figure.

5. For your information, the securities of T.I.S. were originally sold at a public offering on October 30, 1969. They were initially offered only in "Units" valued at $1,333.00 consisting of $1,000.00 principal amount of debentures and 100 shares of common stock valued at $3.33 per share. The certificates representing the debentures and the shares representing the common stock, however, were able to be traded separately immediately after the public offering.

6. You must execute this Proof of Claim before a notary public. If you are a partnership, please indicate that you sign as a general partner. If you are a corporation, please have a duly authorized officer sign and indicate his or her office. If you are a legal representative of the eligible claimant, please indicate your capacity and attach written authorizations in the form of corporate resolution, letters of administration, etc.

7. *You must file this Proof of Claim no later than the 31st day of December, 1978 with Robert H. Jaffe, Esq., of Robert H. Jaffe, P.A., 8 Mountain Avenue, Springfield, New Jersey, 07081.* This Proof of Claim shall be deemed filed when placed in a United States mail box, postage prepaid, or if otherwise filed, when it is actually received by the office of Robert H. Jaffe, P.A.

PROOF OF CLAIM OF ELIGIBLE CLAIMANT

STATE OF :
: ss.
COUNTY OF :

DECLARATION OF CLAIMANT: The undersigned hereby declares he, she or it is either the person or a legal representative of the person who meets the requirements set forth in the above Instructions and Information section to be an eligible claimant to participate in the cash distribution from the partial settlement of this class action.

The undersigned further declares he, she or it is not a named defendant in the above captioned class action or any person who was a director, executive officer, or general partner of any of the named defendants during the 1-year period prior to January 28, 1970.

PURCHASES

At the time of the original offering of securities of T.I.S. or during the period from October 30, 1969 through January 28, 1970, the undersigned purchased:

(a) Common Stock of T.I.S. as follows:

Date of Purchase	No. of Shares	Price per Share	Gross Purchase Cost including comissions and taxes, if any

(b) Debentures of T.I.S. as follows:

Date of Purchase	No. of Debentures Face value	Price per Debenture	Gross Purchase Cost including commissions and taxes, if any
11-13-69	$2,000	63%	$1,275.56

(c) Units of T.I.S. securities as follows:

Date of Purchase	No. of Units	Price per Unit	Gross Purchase Cost including commissions and taxes, if any
11-3-69	1	1,333.	$1,337.89

SALES: Since October 30, 1969 to the date of this Proof of Claim, the undersigned has sold:

(a) Common Stock of T.I.S. as follows:

Date of Sale	Date of Purchase	Gross Sales Price	Gross Purchase Cost (From 1 unit)	No. of Shares	Net Sales Proceeds
11-13-69	11-3-69	$1,275.	334.22	100	$1,255.25

(b) Debentures of T.I.S. as follows:

Date of Sale	Date of Purchase	Gross Sales Price	Gross Purchase Cost	No. of Debentures Value	Net Sales Proceeds
12-29-70	11-13-69	30.	2,279.23	3,000	18.

(c) Units of T.I.S. securities as follows:

Date of Sale	Date of Purchase	Gross Sales Price	Gross Purchase Cost	No. of Units	Net Sales Proceeds

(Please see note at head of next page respecting continuation of schedules, if necessary.)

IF YOU MADE MORE THAN THREE SALES OR PURCHASES OF ONE OR MORE OF THE ABOVE DESCRIBED SECURITIES OF T.I.S., PLEASE CONTINUE THE APPROPRIATE SCHEDULE OR SCHEDULES USING THE SAME HEADINGS AS ABOVE ON AN ADDITIONAL SHEET OF PAPER AND ATTACH IT TO THIS PROOF OF CLAIM.

HOLDINGS: With respect to the securities of T.I.S. which the undersigned purchased either at the original public offering effective October 30, 1969 or during the period October 30, 1969 through January 28, 1970 and which have been identified in the "Purchases" section of this Proof of Claim, the undersigned is presently the owner of:

—0— shares of common stock which have a net cost basis today of $ —0—;

—0— debentures in the total principal face amount of $—0—, having a net cost basis today of $_____;

OR —0— Units having a net cost basis today of $_____.

REIMBURSEMENT OF LITIGATION COSTS: The undersigned has contributed the sum of $20.00 towards the prosecution and/or maintenance of this class action for which reimbursement is sought as part of this Proof of Claim. Contributions or miscellaneous expense for travel and parking for Deposition in Court Appearances, telephone calls to member of committee. Trip to airport to meet with D. Komiss.

Based upon the above, and pursuant to the Instructions and Information section set forth at the head of this Proof of Claim and in the Notice of General Information, the undersigned hereby claims a net loss of $1,360.20 on the above identified purchases and sales made of securities of T.I.S. *Attached to this Proof of Claim you will find all documentation necessary to evidence the purchases and sales claimed.*

The undersigned or the legal representative of the undersigned swears that the foregoing statements are true, correct and complete.

/s/ Chester E. Bradley
Signature of Claimant
or Legal Representative

Sworn and subscribed to before me
this 14 day of December, 1978.
/s/ _____
Notary Public in and for the County
of Tarrant, State of Texas

SCHNEIDER, BERNET & HICKMAN, INC.

2000 FIRST NATIONAL BANK BLDG. DALLAS, TEXAS

	3M	TEXAS INTNATL SPEEDWAY 8-84		1.	12/29/70	1	5

| | | | | | | |

SCHNEIDER, BERNET & HICKMAN, INC.

ESTABLISHED 1930

Member New York Stock Exchange & American Stock Exchange

800 FIRST NATIONAL BANK BLDG. DALLAS, TEXAS

RI 8-1201

2NI | TEXAS INTNATL SPEEDWAY SUB 8-84 | 63 | 11/13/69 | 2 | 3 | P

80772 | 1 | 6 | 41 | 11 | 340 93792 | 1,260.00 | 15.56

ORIGINAL CONFIRMATION

CHESTER E BRADLEY JR
NL 3 4
3421 SOUTHWESTERN
DALLAS TEXAS 75229

1,272.56 | 11/20/69

PAY THIS AMOUNT $

EXHIBIT Px-14 - LETTER DATED 5/20/69 SENT BY HS&G TO LEO MARGOLIAN AND SHARE GIVING DETAIL OF PAVING BIDS

May 20, 1969

Texas International Speedway
c/o Ramada Inn
College Station, Texas 77840

Attn: Mr. Leo Margolian

Re: Turfing and Seeding

Gentlemen:

After the consideration of several bids we have selected the Brazos Valley Nursery as our turfing and seeding subcontractor. We have considered the speedway turf needs and propose to provide the following for $300.00 for acre.

> Grade and smooth topsoil. Apply 960 pounds of 12-12-12 fertilizer. Disc and drag soil (approximately three inches deep) to prepare the seed bed and incorporate fertilizer. Seed with 80 pounds of hulled bermuda and 200 pounds of rye grass per acre. Seed firmed into seed bed by the seeding equipment roller. Topdress with 400 pounds of ammonium sulphate fertilizer per acre after sufficient growth has begun.

Mr. Potts feels that this method will provide maximum turf for race day and good long range turf for future years.

Your very truly,
Holloway Sand and Gravel
Co., Inc.

/s/ Tom Engle

CC: Mr. Leslie Share
Mr. Ed Burkhart
Kent Potts

EXHIBIT Px-16 - LETTER DATED 5/19/69 SENT BY HS&G TO MARGOLIAN AND SHARE DESIGNATING SEEDING SUBCONTRACTOR

May 19, 1969

Texas International Speedway
c/o Ramada Inn
College Station, Texas 77840

Attn: Mr. Leo Margolian

Re: Paving Bids

Gentlemen:

Bids were received from two contractors out of six that were invited to bid. The following is a tabulation of those bids including prime contractor costs and mark-up.

		Jarbet Co.		Texas Bitulithic	
Item	Quantity	Unit	Amount	Unit	Amount
Lime Stabilization	241,109 SY	$0.90	$217,071.00	$1.20	$289,428.00
Black Base	23,997 Tons	8.90	213,573.30	9.44	226,531.68
Binder	15,509 Tons	9.20	142,682.80	9.28	143,923.52
Surface (Lt. Wt.)	8,133 Tons	11.50	93,329.50	14.84	120,693.72
Service Roads	9,058 Tons	8.05	72,916.90	8.68	78,623.44
Asphalt	629,416 Gals	.14	88,118.24	.13	81,824.08
Prime Cost	47,522 Gals	.23	10,930.06	.25	11,880.50
Tack Cost	9,295 Gals	.35	3,253.25	.14	1,301.30
Totals			$842,075.05		954,206.24

Yours very truly,
Holloway Sand and Gravel Co., Inc.
/s/ Tom Engle

CC: Mr. Leslie Share
Mr. Ed Burkhart

EXHIBIT Px-19 - "COMFORT LETTER"
DATED 11/7/69 FROM SPENCER J.
BUCHANAN & ASSOCIATES, INC.
TO LADENBURG

SPENCER J. BUCHANAN AND ASSOCIATES, INC.
CONSULTING ENGINEERS
706 NORTH SIMS – BRYAN, TEXAS
AREA CODE 713 622-3767

7 November 1969

Ladenburg, Thalmann & Co.
25 Broad Street
New York, New York 10004

Gentlemen:

Re: Texas International Speedway, Inc.

In connection with the Prospectus of the above Company, dated October 30, 1969, nothing has come to the attention of the undersigned, as of this date, that would indicate or give us cause to believe that any of the material referred to in said Prospectus as having been included therein in reliance upon the authority of the undersigned as experts in engineering, is not in all respects accurately set forth therein.

Very truly yours,

By: /s/ Edsel J. Burkhart
Spencer J. Buchanan and
Associates, Inc.

EXHIBIT Px-20 - LETTER FROM SHARE TO BUCHANAN DATED 10/21/69 ENCLOSING CONSENT FORM

October 21, 1969

Mr. Edsel J. Burkhart
Spencer J. Buchanan & Associates
P. O. Box 672
Bryan, Texas 77801

Dear Ed:

The enclosed consent form has been requested by the underwriters in connection with the public offering of Texas International Speedway. I am also enclosing a copy of the Prospectus so you can review the matters referred to.

Yours very respectfully,

American Raceways Inc.

/s/ Leslie Share
Executive Vice President

LS:bc
Enclosures(2)

EXHIBIT Px-20A – CONSENT FORM FOR BUCHANAN ENCLOSED WITH PX-20

CONSENT OF SPENCER J. BUCHANAN & ASSOCIATES, INC.

The undersigned hereby consents to the use of its name under the captions "Use of Proceeds" and "Plant and Property" in the foregoing Prospectus.

SPENCER J . BUCHANAN & ASSOCIATES, INC.

By:_____

, 1969

EXHIBIT Px-25 - LETTER FROM H&M TO SHARE DATED 5/20/69 WITH ATTACHED SCHEDULE OF TIS SITE CONSTRUCTION COSTS

Herman & MacLean
CERTIFIED PUBLIC ACCOUNTANTS
3361 PENOBSCOT BUILDING
DETROIT, MICHIGAN 48226

May 20, 1969

Mr. Leslie Share,
Michigan International
Speedway, Inc.,
2990 West Grand Blvd.,
Detroit, Michigan 48202.

Re: Texas International Speedway, Inc.

Dear Les:

A photocopy of a make-up sheet of the amounts which I have shown in the May 20, 1969 copy of the Prospectus Proof as site construction costs is enclosed. As you can see from the note at the top of page 1, we have an overage in costs of $488,000.00 at the moment of which I arbitrarily buried in the safety walls and fences, etc., etc. category (you will find it on page 2 of the enclosure on line 26). In putting these figures together late yesterday afternoon, I first discovered that we had this problem and in the interest of getting some numbers together on paper and tying them in with the rest of the Registration Statement, I thought it imperative to put together what we already had so that we can see where we stand. I had several thoughts of where I might adjust the $488,000.00, but I thought the less approach was to take it out of category and then you and I can simply adjust whatever categories need adjusting so that we can come down to a realistic program based upon the present financing.

As you can see from the top of page 1 and by perusing the various figures, every number has been obtained either from your February, 1969 schedule or your April 24, 1969 schedule.

I have also enclosed a photocopy of page 4 of the May 20, 1969 Proof of the Registration Statement for Texas International Speedway, Inc. with only the obvious corrections already indicated (there are four in number). As you can appreciate, this it the first draft.

I am confident that the amount shown as expenses in the first schedule in the Prospectus will be changed and the aggregate of $459,900.00 will be increased by some amount. That amount excludes any expenses of the underwriter which might be paid and the amount of $60,000.00 was nearly copied from the Michigan Speedway report and I suspect that that amount will be changed.

I have several comments to make with respect to the three page schedule:

1. By virtue of the fact that we have a number of items included in the third category aggregating $871,009.00, I wondered if my description of paving is correct. Should it possibly be paving and access roads?

2. Should the amount which I show on page 2, line 7 of $76,480.00 be that amount or $96,980.00. The answer to this question lies in the interpretation of your April 24, 1969 schedule as to the $20,500.00 that has been shown thereon as "plate" as a pencilled notation.

3. We arbitrarily assumed that boundary fences (page 2, line 9) of $500,000.00 is the same as gates, terminal posts, etc. If it is not, the latter description would need to be added to the three page schedule.

4. We have excluded travel, legal, accounting, insurance and miscellaneous including bonds from the site construction costs schedule as they are included in the category estimated promotional and other administrative expenses to opening date.

5. The amount shown as estimated promotional and other administrative expenses to opening date of $325,000.00 is an amount arrived at by me without any consideration to the detail behind it. As I think I indicated to you before the amount of $243,000.00 which was shown in the Michigan Speedway Prospectus was given to us by Larry and I doubt very much if he had any detail behind it. I have prepared a schedule showing the various items that should be considered at arriving at the amount to be shown therein but have not filled the amounts in as yet. I will do so sometime soon with consultation with Hal Schimmel and go over the entire schedule with you. Let me say that the amount of $325,000.00 is greater than the estimated amount of $243,000.00 on the Michigan Speedway Prospectus; however, the actual amount for Michigan ended up in excess of half a million dollars.

6. On your schedule for land costs, you indicated interest at 6% for six months. It apparently is not in the $1,105,000, cost figure and any reference to the interest should be eliminated at that point. It will be included in the category estimated promotional and other administrative expenses to opening date.

7. As you know I put this schedule that appears in the Prospectus together in somewhat of a hurry late yesterday afternoon and I see in reviewing the items that ended up in the various categories today that perhaps the category headings shown on page 3, line 2 and line 6 and 7 should

be amended. I copied the category descriptions berbatim from the Michigan Prospectus but ended up with the costs of rest rooms and hospital described on line 6 and 7 in the figure shown on line 4 of $161,106.00.

8. In our next set of figures, I suggest that I should round off the various amounts to the nearest $1,000.00 which I will do at that time.

I have absolutely no pride of authorship with respect to the items included in the various categories and the description of the various categories. Therefore, please feel completely free to make any necessary changes that you deem necessary.

Cordially,

/s/ M. Richard Herman

MRH:mw

Site Construction Costs

May 20, '69

Page 1 of 3

Share Fair

F.A.T.

5-12-69

Make up of construction costs and 5/20/69 topographical survey of site.

Note: Do NOT fail to observe the change in cost of $65,000. buried (underground) wall and fence, vehicle and pedestrian, etc.

Codes: (2) information taken from 4/29/69 "Cost Estimate - Total Project" aggregating $4,984,600. furnished by Leslie Shaw.

(4) information taken from 4/29/69 "Cost Estimate - Total Project" aggregating $4,415,500. furnished by Leslie Shaw.

	Discretion	Amount	Total
Center Facilities:			
Land (2,600 acres @ $425. - lot 670 x 670 min.)			$1,105,000(2)
Clearing, Grading and Excavation Site:			
Clearing, grading and excavating - 3,100,000 yds @ .62		$1,922,000(4)	
Topsoil - 125,000 yds @ .52		65,000(4)	
Clearing: Parking, roadways and access		61,750(4)	
Grading: 247 acres @ 1250		600,000(4)	1,278,750
Grading & Parking and access roads			
Pavement:			
Curb (C.P.C. Type)		414,451(4)	
Pot roads		57,821(4)	
Road corners		212,864(4)	
Row roads		47,109(4)	
Access roads:			
Entrance		81,357(4)	
Perimeter		56,707(4)	870,309
			942,75

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Fig 203

		Amount	Totals
SAFETY WALLS AND FENCES, VEHICLE AND PEDESTRIAN TUNNELS, WATER, SANITARY AND DRAINAGE SYSTEMS AND SERVICE BUILDINGS IN FINISHED AND TILED AREAS:			
Concrete safety walls		$ 70,000 (1)	
Pit wall		32,000 (4)	
Guard rail - 8,000 L.F. @ $9.52		76,160 (4)	10
Fences:			
Bandon 20,000 L.F. @ .25		5000 (2)	
Spectator (4') 3,700 L.F. @ 1.17		4329 (4)	
Spectator (6') 12,700 L.F. @ 2.12		25452 (4)	
Security (10') 14,000 L.F. @ 3.27		45780 (4)	
Safety (10') 2,800 L.F. @ 9.00		25200 (4)	
Vehicular tunnels		215000 (4)	
Pedestrian tunnels		32000 (4)	
Frames for parking gates		75000 (2)	2
Storm sewer		82000 (4)	
Sanitary sewer		14200 (4)	
Drainage system		50000 (4)	
Wells		20000 (4)	
Water mains		63000 (4)	
Storage tanks		50000 (4)	
Lift Station		20000 (4)	
Shelters: 300 acres @ 2.00		900000 (4)	
		$ 1139441	
Less Excess of total estimated available financing		488000	651441
ELECTRICAL AND PLUMBING:			
Plumbing		$ 150000 (2)	?
Electrical		50000 (4)	200000
GRANDSTAND AND PRESS FACILITIES:			
Grandstands: 30,240 seats			
Concrete and railing		$ 373940 (4)	
Seats and standards		113254 (4)	
Press box		150000 (4)	
Sky Lounge		90000 (4)	727194

262a

SITE CONSTRUCTION COSTS — PAGE 3 OF 3

(By [illegible], 1[illegible])

	Description			Labor	Total
	SITE IMPROVEMENTS AND CONSTRUCTION FACILITIES:				
	Drainage (3) rest rooms (include emergency communications) (11)				
	community building (1) hospital (1)				161106 (4)
	OTHER FACILITIES INCLUDING COMMUNICATION TOWERS:				
	Public Rest Rooms, Field Houses, Dining etc.:				
	Entrances			25000 (4)	
	General			10000 (2)	
	Locker Rooms			50000 (2)	
	Dining Lounge			20000 (2)	
	Public address			7500 (2)	
	Communications			2500 (2)	
	Field supervision and office			35000 (2)	
	Office equipment and furniture			5200 (2)	
	Utilities and Misc			5000 (2)	250000
	CONTRACTORS AND CONTINGENCIES:				250000 (4)
	ARCHITECTURAL AND ENGINEERING SERVICES:				
	Architecture and engineering including inspection			210000 (4)	
	Consultants			30000 (4)	240000
					5734500
	TOTAL PUBLIC AND PRIVATE STOCK AND DEBENTURE FINANCING (NET OF EXPENSES) AND MORTGAGE AND SUBSECTION 221 (D) (3) FINANCING:				6477100
	LESS NON-SITE CONSTRUCTION COSTS:				
	Land costs			350000	
	Estimated promotional and other administrative expenses to going state			325000	
	Mortgage amortization fee			30000	
	Balance available for general corporate purposes			37100	742100
					5734500

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6. The development and operation of an automobile race track is a venturesome business, dependent upon the availability of sanctions, suitable weather conditions on scheduled racing dates, the ability to attract enough drivers and spectators to enable it to operate profitably, as well as the changing desires of the public for various types of entertainment and competition of other similar enterprises.

USE OF PROCEEDS

The total net proceeds to the Company of all its financing including previous financing and present financing (after deduction of estimated expenses and Underwriters' discounts) is as follows:

		Amount
Proceeds of this offering:		
Proceeds of sale of $3,000,000 of Participating Subordinated Debentures and 300,000 shares of Common Stock		$3,999,000
Less: Underwriters' discount and expenses	$ 399,900	
Expenses in connection with this offering	60,000	459,900
		$3,539,100
Proceeds of previous financing (see captions "Capitalization" and "Organizational Transactions" herein)		1,188,000
		$4,727,100

The Company has applied such proceeds, or estimates that such proceeds will be applied by it, for the following purposes:

	Amount
Cost of real estate	$1,105,000
Clearing, grading and excavating site	1,278,750
Paving	871,009
Safety walls and fences, vehicle and pedestrian tunnel, water, sanitary and drainage system and seeding of parking and other areas	651,441
Electrical and plumbing	200,000
Grandstand and press facilities	727,194
Shops, tuneup and concession buildings	161,100
Other facilities including communication towers, public rest rooms, field hospital, signs, etc.	250,000

Construction contingencies		250,000
Architectural and engineering services		240,000
Sanction Costs		350,000
Estimated promotional and other administrative expenses to opening date		325,000
Mortgage commitment fee (1)		30,000
Balance available for general corporate purposes		37,600
		$6,477,100
Less: Portion of above being financed by:		
First real estate mortgage (1)	$1,500,000	
Deferral of liability for sanction costs	250,000	1,750,000
		$4,727,100

(1) See caption "Description of Mortgage Commitments" herein.

EXHIBIT Px-26 - LETTER FROM H&M TO SHARE DATED 6/9/69 WITH ATTACHED SCHEDULE ENTITLED TIS COST ESTIMATE 6/8/69

Herman & MacLean
CERTIFIED PUBLIC ACCOUNTANTS
3361 PENOBSCOT BUILDING
DETROIT, MICHIGAN 48226

June 9, 1969

Mr. Leslie Share,
Michigan International
Speedway, Inc.,
2990 West Grand Blvd.,
Detroit, Michigan 48202.

Dear Les:

A schedule entitled "Cost estimate-Texas International Speedway, Inc. - June 8, 196" is enclosed for your perusal.

The enclosure embodies all of the costs included on your June 4, 1969 schedule as amended by the reductions which were agreed upon on Sunday at Larry's house. I have accounted for every item number on your June 4, 1969 estimate including those that have now been reduced to zero. I have added the other cost items which will be included in the use of proceeds section in the Registration Statement to arrive at a total budget cost of $6,213,038. When you see the next proof you will observe that the aggregate of the initial common stock investment, net proceeds from the public offering, first real estate mortgage and deferral of liability for racing sanction costs aggregates $6,391,733. leaving a balance available for general corporate purposes of $178,695.

I've also enclosed the detail behind Hal Schimmel's and my estimate of the estimated promotional and other administrative expenses to opening date.

I wish that you would review all of the enclosures to ascertain if the descriptions and dollar amounts tie-in with your understanding of what was agreed upon as well as to make sure that I have the proper descriptions in the use of proceeds section in the Registration Statement.

Cordially,

/s/ M. Richard Herman

MRH:MW
enclosure

JUNE 8, 1969 (SHEET 1 OF 4)

ITEM NO. ON 6-4-69 SCHEDULE				SHARE F.A.T. 5-12-79	EX #9	
COST OF REAL ESTATE:						
2	REAL ESTATE					$1,119,120
CLEARING, GRUBBING AND EXCAVATING SITE:						
1	CLEARING, GRUBBING AND EXCAVATING 2,100,000 YDS @ .52				$1,092,000	
2	TOPSOIL - 125,000 YDS @ .52				65,000	
3	PAVING: PARKING, ROAD COURSE AND ACCESS ROADS: 295 ACRES @ 250				73,750	
4	GRADING: PARKING AND ACCESS ROADS				75,000	
5	UNDERPINNING				50,000	1,355,750 X
TRENCHES:						
8	PAVING				2.0	687,143 X
SAFETY AND PIT WALLS, FENCES, VEHICLE AND PRESS TUNNELS, WATER AND SEWER SYSTEMS AND GUARD RAILS						
6	FENCING				$2,469	X
7	SAFETY FENCE - 2400 L.F. @ 10.00				24,000	X
9	CONCRETE SAFETY WALL - 2748 FT. @ 25.00				68,700	X
10	PIT WALL - 3200 FT. @ 10.00				32,000	X
11	BOOSTER PLATE - GUARD RAIL - 8000 L.F. @ 14.50				116,000	X
12	VEHICULAR TUNNELS				$21,836	X
13	PRESS TUNNEL				34,470	X
14	STORM SEWER				1,200	X
15	SANITARY SEWER AND INDUSTRIAL SYSTEM				2,200	X
16	WELLS, WATER MAINS AND DISTRIBUTION				5,000	X 567,725
GRANDSTANDS AND PRESS FACILITIES:						
	GRANDSTANDS: 25,720 SEATS				-0-	
F3	CONCRETE AND PAVING				324,160	X
81	SCORE AND NUMBERS				161,092	X
82	PRESS BUILDING AND FIRE CONTROL				111,692	608,244
SHOPS, TOOL AND CONCESSION BUILDINGS:						
24	FOUNDATIONS AND SLABS				25,613	X
25	STEEL BUILDING				77,843	X
26	EXTERIOR ATTACHING: PLUMBING, ELECTRICAL, MECHANICAL, PAINTING, TOILET PARTITIONS				53,000	X
				INSTALLATION AND CONNECTIONS	13,000	
27	BUILDING ALTERATIONS AND ADDITIONS				6,600	175,056
				BALANCE FORWARD		

Best Copy Available

EXHIBIT E - TEXAS INTERNATIONAL SPEEDWAY

JUNE 8, 1969 (PAGE 2 of 4)

ITEM No. on 6-4-69 SCHEDULE			
	BALANCE BROUGHT FORWARD		$ 4,818,038
	COST OF CONSTRUCTION COSTS:		
29	ELECTRICAL	$ 60,000 ✓	
32	PUBLIC ADDRESS - GENERAL TELEPHONE AND TIE.	5000 ✓	
37	OFFICE EQUIPMENT AND FURNITURE	5000 ✓	
38	VEHICLES AND TRUCKS	5000 ✓	
43	M.I.S. ALLOCATION - OVERHEAD	100,000 ✓	
17	SEEDING: 330 ACRES @ 300.	-0-	
18	ENTRANCES	-0-	
23	SCORERS STAND	-0-	
28	SCOREBOARD	-0-	
27	DRIVERS LOUNGE	-0-	
31	COMMUNICATIONS - GENERAL TELEPHONE	-0-	
40	FLAG POLES	-0-	
35 *	FIELD SUPERVISION AND OFFICE	-0-	
36 *	TRAILER	-0-	175200
39 *	INSURANCE AND BONDS		
	FUTURE ARCHITECTURAL AND ENGINEERING SERVICES:		
33	ARCHITECTURAL AND ENGINEERING INCLUDING INSPECTION	$ 210000	
34	CONSULTANTS	30000	240000
	CONSTRUCTION AND OTHER CONTINGENCIES:		
41	CONTINGENCIES 5%	$ 200496	
44	OTHER CONTINGENCIES	24304	225000
	TOTAL CONSTRUCTION BUDGET		$ 5158038
	PACING SANCTION COSTS		350,000
	ESTIMATED PROMOTIONAL AND OTHER ADMINISTRATIVE EXPENSES TO OPENING DATE		110000 (1)
	TOTAL BUDGET		$6213038
	BALANCE AVAILABLE FOR GENERAL CORPORATE PURPOSES		178695
			1391733

* - INCLUDED IN ESTIMATED AND OTHER ADMINISTRATIVE EXPENSES TO OPENING DATE

(1) - SCHEDULE ATTACHED

Best Copy Available

MICHIGAN INTERNATIONAL SPEEDWAY, INC.
BUILDING PRE-OPERATING EXPENSES VS.
PROPOSED BUDGET FOR TEN

			M.I.S.	T.I.S.
360	CONSULTING SERVICES	L.H.L.	7,420.00	—
362	"	L.S.	14,120.28	—
364	"	G.K.	2,235.00	—
365	GENERAL MANAGERS SALARY		—	16,000
368	CLERICAL SALARIES		32,773.35	7000
369	PUBLIC RELATIONS SALARIES		5,252.50	—
371	SECRETARY AND RECEPTIONIST EXPENSE		1,493.20	—
372	INSTITUTIONAL ADVERTISING AND PUBLIC RELATIONS		31,033.19	35,000
373	AUTO EXPENSE		2,228.07	2000
374	SALES PROMOTION		47,443.05	40000
375	CAR LEASE EXPENSE		2,130.08	3000
377	TRAVEL AND ENTERTAINMENT		37,320.62	37000
379	PARKING EXPENSE		736.00	—
383	TELEPHONE		2,917.62	1000
384	OFFICE SUPPLIES		12,024.82	12000
386	POSTAGE		7,273.94	5000
388	PROFESSIONAL FEES		42,270.65	37000
390	DUES AND SUBSCRIPTIONS		170.30	—
394	MISCELLANEOUS		4,326.06	5000
395	DELIVERY EXPENSE		455.86	400
396	INSURANCE		3,352.57	4000
397	DIRECTORS FEES		1,000.00	1000
399	EMPLOYEES HOSPITAL INSURANCE		2,779.94	—
370	PAYROLL TAXES		1,550.71	400
380	EXECUTIVE OFFICE RENT		7,162.13	—
382	OTHER RENTS		12,000.00	2000
392	PROPERTY TAXES		2,731.66	5000
363	OTHER M.I.S. OVERHEAD ALLOCATION (REFLECTS 25% CHARGE		—	8000
			400,710.69	294,800
363	OTHER M.I.S. OVERHEAD ALLOCATION (REFLECTS 50% CHARGE		—	52955
		BALANCE FORWARD	400,710.69	347,755

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MICHIGAN INTERNATIONAL SPEEDWAY, INC.
DEFERRED PRE-OPERATING EXPENSES VS. PROPOSED BUDGET FOR TEXAS

PREPARED BY
APPROVED BY

(PAGE 1 OF 4)

LINE NO							
1			BALANCE BROUGHT FORWARD			400,710.69	347755
2							
3	130	LAND IMPROVEMENTS				352.92	—
4	400	TRANSFER AGENTS FEE				756.18	1000
5	407	RENT (INCOME)				(326.43)	—
6	410	INTEREST EXPENSE				92,166.69	100000
7	412	INTEREST INCOME					(10000)
8	416	DEBENTURE DISCOUNT AND EXPENSE				25,329.84	5000
9		INTEREST AND DEBENTURE DISCOUNT NOT					(45000)
10		PAYABLE AT COMPLETION					
11	418	MISCELLANEOUS				643.43	5045
12	434	ORGANIZATION EXPENSE				1702.21	1000
13							
14						540,776.53	405000
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EXHIBIT Px-31 - SEC LETTER OF COMMENT TO LOREN T. ROBINSON, JR., ESQ. DATED 8/21/69

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Division of Corporation Finance

August 21, 1969

AIR MAIL

Loren T. Robinson, Jr., Esq.
Scholl, Jenkins, Robinson & Stieg
1051 Penobscot Building
Detroit, Michigan 48226

Re: Texas International Speedway, Inc.
File No. 2-33510
22-5627

Dear Sir:

We have the following comments with respect to the non-financial portions of the above registration statement and pre-effective amendment No. 1 thereto, filed on June 17, and July 1, 1969 respectively. Our comments with respect to the financial statements will follow shortly.

All information in the prospectus should be updated to the latest practicable date. This comment is especially applicable to contracts, agreements, etc. relating to the construction of proposed track, operating agreements, etc.

Facing Page: Signature Page

The guarantee of Michigan International Speedway, Inc. should be included in the registration statement as a separate security and Michigan International should be in-

cluded as a registrant with respect thereto. Such signatures in the next amendment should adopt the registration statement as originally filed and as amended.

Prospectus

Cover Page

The statement "These Securities Involve A High Degree of Risk" should replace "These Are Speculative Securities."

Reference is made to Section 18 of Securities Act Release No. 4936. If applicable a reference should be included on the cover page to the section wherein the indicated information is disclosed.

The caption of the second column should read "Cash Underwriting Discounts and Commissions." The figures in the column should be increased to reflect the payment to the underwriter for both his expenses and those of counsel. In this connection, the first sentence of footnote 2 should specify the respective amounts of such commissions and expenses on a per share and aggregate basis. This footnote (2) should also include a reference to the five year rights of first refusal with respect to future financing and the rights to indemnification.

Footnote 3 should indicate also the per share expenses and also the general categories of expense.

All footnotes should be printed in 10 point type.

The word "risk" should be substituted for "speculative" in the last sentence of the paragraph following the notes. This paragraph should be printed in bold face italicized print.

Introductory Statement - Pages 3-4

Paragraph 1 should be expanded to indicate that although the present stockholders were able to obtain solely an equity investment in the company, those purchasing pursuant to this offering must invest $3 in the company's debt securities for each dollar they invest in the company's equity securities at a time when the company would almost certainly be unable to sell such debt securities except at a prohibitive rate of interest.

The first sentence of paragraph 2 should indicate generally the type of risks to which a new enterprise is subjected.

Paragraph 4 should be expanded to indicate that of the total preparation, construction promotional and administrative expenses estimated by the company to be $_____, approximately $_____ (_____%) of such costs are based not on firm contracts but on estimates by the company, its architects and engineers.

It is assumed that the subscription agreements will be called by the company prior to the effective date of the registration statement. If otherwise, appropriate commentary should be included in paragraph 6 hereunder and appropriate revisions made elsewhere in the prospectus.

Paragraph 8 should be expanded to indicate (1) the fact that the officers and directors of the registrant will in all probability devote a majority of their time to other businesses including that of the parent, (2) the estimated amounts to be payable to Michigan for services up to commencement of operations and (3) the basis for the management fee to Michigan subsequent to commencement of operations or November 9, 1969, whichever is earlier.

Use of Proceeds - Pages 4-5

The estimated amounts to be paid to Michigan International should be set forth as a separate item in the tabulation on page 5.

As supplemental information please furnish in reasonable detail the basis for the estimates provided hereunder. Such information should include the identity of those making the estimates, specific information on prices including quantities and units involved, description of the plans, specifications, etc. upon which such estimates are based and any other similarly applicable information bearing on this subject.

The first sentence of the penultimate paragraph on page 5 or the tabulation itself should indicate which of the estimates are based on "unit price contracts," which term should be briefly explained. Similarly, those costs which are now determined such as acquisition costs and work completed should be identified. Copies of all contracts to date should be filed as exhibits to the registration statement.

Capitalization - Page 6

The capitalization table in the final prospectus should be as of a date not more than 30 days prior to the date of such prospectus.

Sentences 2 and 3 of footnote 2 should be expanded to indicate the amount of the required annual instalments.

The last sentence of footnote 2 should be replaced with one that heads substantially as follows: "At the present time there is no likelihood that this may be accomplished in the foreseeable future.

History and Business - Pages 6-10
Proposed Business - Pages 6-7

The information hereunder should be expanded to indicate, if true, that since most of the major companies in the automobile industry are headquartered and have much of their facilities in the midwest, it is at least questionable whether the company will be able to obtain the commitments noted in the penultimate sentence of the paragraph at the top of page 7.

Automobile Racing - Page 7

It is suggested that the abbreviation FIA as used in the second paragraph hereunder be explained therein.

Sanctions - Pages 7-8

The nature and extent of fees and/or the basis for fees should be indicated in the last paragraph hereunder.

Personnel - Pages 8-9

It is suggested, in view of the disclosure under "Management" that the information hereunder is superfluous. Relevant information covered hereunder and not elicited thereunder maybe inserted as appropriate. In this connection also, the relationship and interrelationship of the registrant, Michigan International, Atlanta International and Riverside International as of the latest practicable date should be indicated with more specificity. The extent of time expected to be devoted to the officers and directors to the affairs of the registrant should be disclosed.

Prizes - Page 9

It is noted that the method or basis for prizes as described hereunder is different from the description in the

Michigan International prospectus. It is assumed that no other basis, i.e., minimum attendance, etc. are used in determining the amount of prize money. Please advise.

Sources of Revenue - Page 9

The "rentals from tire, gasoline and automotive companies" should be clarified in the first paragraph hereunder. Reference is made to our previous comment under "Introductory Statement" in this regard.

Concession Agreement - Page 9

Please advise as to the present status of negotiation with respect to the concessions agreement.

Plant and Property - Pages 10-13

Subsequent amendments to the registration statement should update the material hereunder with respect to extent of completion, status in relation to schedules, bids, etc.

In connection with the incomplete paragraph at the top of page 12, the company's intention with respect to the payment of the claim should be indicated. Counsel referred to therein should be named and the consent to being so named should be furnished. Please furnish the identity of the persons making the claim as supplemental information.

Trust Indenture
Description of Debentures - Pages 14-16

The following comments are noted with respect to the trust indenture.

Section 2.05; second paragraph

Provisions should also be made for the (original) registration of debentures in addition to registration of transfers.

Section 6.04

The reports should be dated as of May 15, or the day and month as of which the indenture is dated, if dated subsequent to May 15.

Section 8.01(d)

The phrase "it shall have" in line four should be changed to "there shall be."

Section 8.10(d)

The word "any" should be inserted before the word "appointment" in line one in order to reflect the comparable provision in Section 610(a) of the model indenture of the American Bar Foundation dated 1967, written in negative form which the indenture provision purports to follow.

Organizational Transactions - Page 16

Reference is made to our previous comment regarding subscriptions for the outstanding stock. It is assumed that when such subscriptions are called, payment will be made in cash. Please advise.

Transactions With Affiliated Persons - Pages 19-20

Further information should be set forth in order to indicate the manner by which the parent company will actually furnish management services to registrant.

The amount paid or accrued to Michigan International Speedway up to the present time pursuant to the agreement described in the second sentence of the first

paragraph hereunder should be set forth. The reason for the arrangements described in the first paragraph are not immediately apparent and should be indicated as appropriate together with the use of the basis indicated. The amount of expense incurred by the parent company in the comparable period assuring a commencement date in November 1969 for the registrant should be indicated.

The second paragraph hereunder should be expanded to indicate Michigan International's executive office overhead cost for its latest fiscal year and that budgeted for the present fiscal year. The status of the proposed agreements with Riverside and Atlanta should be given as of the latest practicable date. The information in the third sentence appears to be inconsistent with the description of the arrangements. In this connection, it should be indicated that the greater the gross revenues received by the registrant, the greater the management expense payable to Michigan, regardless of the time spent by Michigan's officers, etc. on the affairs of the registrant and also that Michigan will not assume any of its own overhead costs. It also appears that some indication of the gross revenues received by Riverside, Atlanta and any other tracks under similar arrangements for each of the last three respective years of operations or since commencement of operations, whichever is longer, should be indicated.

With respect to the last paragraph on page 19 carrying over to page 20 please furnish as supplemental information a copy of the minutes of the registrant's directors meeting at which the subject opportunity was considered and refused.

Underwriting - Pages 20-21

The essence of Section 5(1) of the Underwriting Agreement dealing with the underwriter's right of first refusal of future offerings should be disclosed hereunder.

It should be indicated hereunder, if true, that all of the shares must be purchased if any are purchased.

Financial Statement

In connection with the foregoing, a brief description of the business and operations of Michigan and Riverside should be included in the prospectus.

PART II

Undertakings

The undertaking indicated in Section 10 of Securities Act Release 4936 should be included in the amendment.

General

Your attention is directed generally to Securities Act Release 4936 and in particular to Items 19, 20 and 42 thereof.

It is assumed that each of the prospective underwriters has taken into account the amount of his proposed commitment in determining whether or not his participation in the underwriting will affect the ratio of his aggregate indebtedness to his net capital required by the provisions of Rule 15c3-1 promulgated by the Commission pursuant to the authority vested in it by Section 15c(3) of the Securities Exchange Act of 1934.

In connection with all amendments to the registration statement, at least three marked copies of the prospectus indicating the changes should be furnished in addition to the number otherwise required.

In connection with each revision of the prospectus prior to the effective date, it is requested that six unmarked copies, in addition to those required by the General Rules

and Regulations, be furnished, marked attention of Mr. C.T. Bodolus, Room 555, Capital Mall, Washington, D.C. 20549, Area Code 202-755-1728.

In connection with any request for acceleration, your attention is directed to Rule 461 and to the statement of the Commission's policy with respect to such requests set forth in Rule 460. Any such request should be made in writing and should be signed by the registrant and the managing underwriter. It is suggested that such request be submitted at least five days prior to the effective date requested and be qualified by the phrase "or as soon thereafter as possible."

It is requested that this Division be advised, prior to the proposed effective date for the subject registration statement, as to whether the proposed offering has been reviewed by the NASD from the viewpoint of that Association's rules and policies concerning underwriters' compensation and arrangements, and free-riding and withholding and what advice has been received as to the status of this review.

As supplemental information, please advise as to the states in which it is intended to make the offering, the steps taken in qualifying the offering therein, and the nature and extent of any difficulties encountered to date.

Please furnish as supplemental information, at least several days prior to the anticipated effective date of the registration statement, the total indications of interest received by underwriters and selling group members from the public, including dealers who are not members of the selling group. This total should be accompanied by a list showing by appropriate categories such as individuals, institutions, dealers not in selling group, etc., the total indications received from those in each category. A copy of

the above information along with a copy of the amended prospectus should be furnished to our New York Regional Office at 26 Federal Plaza, New York, New York 10007 and our Forth Worth Regional Office at 503 U.S. Court House, 10th and Lamar Streets, Fort Worth, Texas 76102 (where underwriter is located or it is anticipated principal distribution will be made), and the letter of transmittal of such information to us should indicate that this has been done.

Reference is made to the procedure outlined in the enclosed Securities Act Release No. 4968 which should be followed.

Sincerely yours,

/s/ Carl T. Bodolus
Branch Chief

Enclosure:
SA Release No. 4968

cc: James C. Sargent, Esq.
Parr, Doherty, Polk & Sargent
80 Broad Street
New York, New York 10004

EXHIBIT Px-32 - SEC LETTER OF COMMENT TO ROBINSON DATED 9/15/69

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Division of Corporation Finance

September 15, 1969

AIR MAIL

Loren T. Robinson, Jr., Esq.
Scholl, Jenkins, Robinson & Stieg
1051 Penobscot Building
Detroit, Michigan 48226

Re: Texas International Speedway, Inc.
File No. 2-33510
22-5627

Dear Sir:

Supplementing our letter of August 21, 1969, we have the following comments with respect to the financial statements in the above registration statement on Form S-1 filed on June 17, and amended July 1, 1969.

Financial Statements - Pages 23-28; II-3 - II-4

The financial statements of Michigan International Speedway, Inc. should be furnished up to the latest practicable date on a certified basis as if it were the registrant. Texas International's financial statements should be as of the same date.

In view of the relationship with Michigan International it is assumed that the notes to both Texas International's and Michigan International's finanicial statements will include explanations as to the method and basis for charges to Texas International by its parent company.

Note B on page 28 should state the basis and time period over which sanction costs are to be amortized.

Note G, page 29, should be expanded to include a comment on "50% of the difference, if any, between costs incurred by the company from date of its incorporation to the date of commencement of operations . . . and comparable costs incurred by Michigan . . . during the same period . . . ." The amount of Michigan's costs should be stated in the note.

The balance sheet on page 24 should show a subtotal for Shareholders' Equity.

The response to Item 31(a), page II-2 should list the financial statements and schedules furnished.

Unless the registration statement is amended promptly, to become effective promptly, updated certified financial statements will be required.

Currently dated manually signed accountants' consents should be included in the amendment.

In line with the foregoing comments, the prospectus should be expanded to include a discussion of the business, properties, operations, etc. of Michigan International. See particularly Items 5-12, 16, 19 and 21 of Form S-1.

Sincerely yours,

/s/ Carl T. Bodolus
Branch Chief

cc: James C. Sargent, Esq.
Parr, Doherty, Polk & Sargent
80 Broad Street
New York, New York 10004

EXHIBIT Px-33B - LETTER TO ROBINSON FROM H&M DATED 10/9/69

Herman & MacLean
CERTIFIED PUBLIC ACCOUNTANTS
3361 PENOBSCOT BUILDING
DETROIT, MICHIGAN 48226

October 9, 1969

Mr. Loren T. Robinson, Jr.
Scholl, Jenkins, Robinson & Stieg,
1051 Penobscot Building,
Detroit, Michigan 48226.

Re: September 15, 1969 letter from
Securities and Exchange Commission,
Washington, D.C. 20549
Texas International Speedway, Inc.
File No. 2-33510; 22-5627

Dear Sir:

Pursuant to your request, we are, in this letter, answering point by point the comments contained in the subject letter with respect to the financial statements contained in the above Registration Statement.

In accordance with our discussions with you, the financial statements of Michigan International Speedway, Inc. have not been furnished. The unaudited August 31, 1969 balance sheet and the statements of cash receipts and disbursements for the period from January 13, 1969 to August 13, 1969 of Texas International Speedway, Inc. have been included.

In Note G, the reference to "Transactions with Affiliated Persons" has been eliminated and in lieu thereof four paragraphs have been added to Note G covering in

detail the method and basis for the charges being made by American Raceways Inc., formerly Michigan International Speedway, Inc. (the parent company of Texas International Speedway, Inc.) to Texas International Speedway, Inc.

A sentence has been added to Note B indicating the basis and time period over which the sanction costs are to be amortized.

As stated previously, Note G has been expanded and includes a comment on "50% of the excess, if any, . . .". The amount of the parent's cost has been stated in the footnote.

The May 31, 1969 and August 31, 1969 balance sheets as well as the pro forma balance sheet-May 31, 1969 now have subtotals for shareholders' equity.

Item 31(a) in Part II has now listed in it the financial statements and schedules being furnished in Amendment No. 2.

A new currently dated, manually signed consent has been made.

In accordance with our discussions with you, we did not respond to the last paragraph of the September 15, 1969 letter inasmuch as we understand that you will respond to this comment.

Other changes have been made to the financial statements which were not covered in the September 15, 1969 letter from Securities and Exchange Commission which reflect transactions which have occurred since the date of our last opinion including collection of stock subscriptions receivable, indication in Note B that $12,500 has been paid on the Sanction Agreement, indication of borrowings

made by the Company in Note J, updating of the status of the various construction and other contracts which have been entered into by the Company as set forth in Note G, the indication of new litigation against the Company in Note G, the disclosure of the warrants to be issued to Ladenburg, Thalmann & Co. in Note H and the updating of the Notes to Financial Statements to include references to the unaudited August 31, 1969 financial statements with appropriate parenthetical comment at the top of the pages of the Notes to Financial Statements indicating that these notes are not covered by the opinion of the Independent Certified Public Accountants.

Very truly yours,

Herman & MacLean

H&M:mw

EXHIBIT Px-34B - LETTER TO ROBINSON FROM H&M DATED 10/27/69

Herman & MacLean
CERTIFIED PUBLIC ACCOUNTANTS
3361 PENOBSCOT BUILDING
DETROIT, MICHIGAN 48226

October 27, 1969

Mr. Loren T. Robinson, Jr.,
Scholl, Jenkins, Robinson & Stieg
1051 Penobscot Building
Detroit, Michigan 48226

Re: Texas International Speedway, Inc.
File No. 2-33510; 22-5627

Dear Sir:

Pursuant to your request, we are, in this letter, summarizing the changes which have been made to the financial statements in the above Registration Statement being amended today.

The unaudited historical balance sheet of August 31, 1969 has included in it a segregation of the deferred revenues received by the Company to August 31, 1969.

The pro forma balance sheet has reflected therein the changes brought about by the increase in estimated offering expenses to $140,000.

The notes to financial statements have been changed as follows:

1. Note C has been changed to reflect the current status of the note payable to the bank at

August 31, 1969 and the current status of the $50,000 payment due under one of the two promissory notes which are secured by real estate.

2. Note G has been up-dated to reflect the current estimate of contractual and other obligations involved in the construction of the track, as well as minor revisions in the language with respect to the management agreement and the insertion of a paragraph concerning the threatened litigation.

3. Note H has been changed to reflect the current status of the option to the contractor. The language in connection with the warrant to purchase 23,000 shares has been up-dated.

Very truly yours,

Herman & MacLean

P.S. We should call to your attention the fact that the type size in which the financial statements are set was changed in Amendment No. 3. This change resulted from a change in printers.

EXHIBIT Px-36 - ARI THIRD QUARTER REPORT FOR PERIOD ENDING 8/31/69

2990 West Grand Blvd., Detroit,
Michigan 48202/Telephone (313) 872-2200

THIRD QUARTER REPORT TO SECURITY HOLDERS

We are enclosing a Consolidated Balance Sheet as of August 31, 1969 and Consolidated Income and Retained Earnings and a Consolidated Statement of Additional Paid-In Capital for the period then ended for American Raceways Inc. and its subsidiaries.

Results of operations for the period are, of course, disappointing but are not surprising in view of the almost inconceivably bad luck the Company encountered in weather conditions, having had rain (and even a little snow in the case of the May race) on all of the race dates during this period. Nor do we expect any improvement in the earnings picture as a result of the revenues from the Canadian-American Challenge Cup Race run in the fourth quarter, inasmuch as this was a "glamour" race, a new type of racing heretofore not marketed in this area, which was not anticipated to do more than give the Company's track prestige and publicity, and to absorb some overhead.

On the other side of the ledger, however, we believe solid progress on the marketing program for the Company's track, and other tracks in which it has an interest, should bear fruit in 1970 with a little cooperation from the elements. We have begun the implementation of the American Raceways' concept of operating these tracks from a central office here in Michigan which will feed all

the tracks with not only marketing tools; promotion and publicity, but personnel during race weekends. In so doing, we become a year-round business by one management, which, I think, is an important key to profitable participation in automobile racing in the coming years.

I previously reported to you in the first and second quarter reports on the acquisition of interests in Atlanta International Raceway and Riverside International Raceway. Since the end of the third quarter, the public offering of the stock and debentures of the Company's 56% subsidiary, Texas International Speedway, Inc., has been closed, the track completed and racing commenced thereon. In addition, acquisition of the real estate, and rezoning thereof, for the construction of Eastern International Speedway (through a presently wholly-owned subsidiary Eastern International Speedway, Inc.) in Burlington County, New Jersey has been completed. This track will serve the New York and Philadelphia markets. Plans for the financing of construction of Eastern International Speedway are under way, and should be completed soon.

/s/
LAWRENCE H. LoPATIN
President

AMERICAN RACEWAYS INC.
(Formerly Michigan International Speedway, Inc.)

CONSOLIDATED BALANCE SHEET
August 31, 1969
(Unaudited)

ASSETS

CURRENT ASSETS:		
Cash and cash equivalent		$ 135,188
Accounts receivable, net of allowance for doubtful accounts of $5,000		282,482
Inventories at lower of first-in, first-out cost or market		16,045
Deferred current operating, administrative and other expenses		67,830
Prepaid sanction costs and other prepaid items		113,160
TOTAL CURRENT ASSETS		$ 614,705
INVESTMENTS IN AND SECURED NOTES RECEIVABLE FROM OTHER COMPANIES, AT COST		3,528,484
PROPERTY, PLANT AND EQUIPMENT, AT COST, NET OF ACCUMULATED DEPRECIATION OF $203,953		9,188,683
DEFERRED CHARGES, NET OF ACCUMULATED AMORTIZATION:		
Pre-operating, promotional, development and net interest costs	$665,509	
Other	108,200	773,709
OTHER ASSETS:		
Racing sanction costs, less current portion	$275,000	
Real estate held for future use	356,972	
Deposits	29,325	661,297
		$14,766,878

The attached note to financial statements is an integral part of this statement.

AMERICAN RACEWAYS INC.
(Formerly Michigan International Speedway, Inc.)

CONSOLIDATED BALANCE SHEET
August 31, 1969
(Unaudited)

LIABILITIES		
CURRENT LIABILITIES:		
Notes payable, including $104,350 current portion of long-term debt		$ 951,339
Liability for racing sanctions		62,500
Deposit from concessionaire		50,000
Accounts payable	1,326,866	
Accrued expenses		191,958
Accrued current operating, administrative and other expenses		22,000
Deferred revenue		66,347
TOTAL CURRENT LIABILITIES		$ 2,671,010
Long-term secured debt, less current portion	$2,532,825	
Liability for racing sanctions, less current portion (payable $25,000 annually)	425,000	
Deposit from concessionaire, less current portion (payable $50,000 annually)	175,000	
Convertible notes payable	6,000,000	
Participating subordinated debentures payable	218,200	9,351,025
Minority interest in subsidiary		63,100
STOCKHOLDERS' EQUITY		
Capital stock, common, no par value, stated value 83-1/3¢ per share, authorized 2,500,000 shares, issued and outstanding 875,588 shares	$ 729,656	
Additional paid in capital	2,435,492	
Retained earnings	(483,405)	2,681,743
		$14,766,878

AMERICAN RACEWAYS INC.
(Formerly Michigan International Speedway, Inc.)

CONSOLIDATED STATEMENT OF ADDITIONAL PAID-IN CAPITAL
Nine months ended August 31, 1969
(Unaudited)

Amount at December 1, 1968		$ 2,089,790
Credit arising from the exchange of $397,000 of Participating Subordinated Debenture, accumulated interest and income participation premium relating thereto of $14,711	$411,711	
Less: Unamortized bond discount and expense and other expenses applicable to the bonds exchanged	47,902	
	$363,809	
Less: Stated value of 21,728 shares (after giving effect to 3 for 1 stock split) issued in connection with the recapitalization	18,107	345,702
Amount at August 31, 1969		$ 2,435,492

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS
Nine Months ended August 31, 1969
(Unaudited)

Revenues from operations		$ 824,845
Expenses:		
Race expenses	$881,247	
General and administrative expenses	408,996	
Other income, net of other deductions	187,693	
Credit for Federal and other income taxes	(75,163)	$ 1,402,773
NET LOSS - NOTE A		(577,928)
Retained earnings at beginning of period		94,523
Retained earnings at end of period		$ (483,405)
Net loss per share of Common Stock based upon average shares outstanding during the period		($ .66)

NOTE TO FINANCIAL STATEMENTS
August 31, 1969

(A) Accrued Current Operating, Administrative and Other Expenses and Deferred Revenues.

Operating results are determined on the basis of each race held during the fiscal year. There were three races held during the nine months ended August 31, 1969. The consolidated statement of income and retained earnings includes direct race charges, other expenses and a credit for Federal and other income taxes. The other expenses have been determined in the proportion that the revenues (net of direct race charges) for the nine months ended August 31, 1969, bears to the actual revenues (net of direct race charges) for the fiscal year. The revenues that have been collected and expenses that have been incurred which are applicable to future races have been deferred and are included in current liabilities and current assets respectively.

EXHIBIT Px-37 – UNDERWRITING AGREEMENT
DATED 10/30/69
BETWEEN TIS AND LADENBURG

3,300 Units

TEXAS INTERNATIONAL SPEEDWAY, INC.

Each Unit Consists of:
$1,000 8% Participating Subordinated Debenture
Due October 15, 1984
and
100 Shares of Common Stock
($1.00 Par Value)

UNDERWRITING AGREEMENT

New York, New York
October 30, 1969

Ladenburg, Thalmann & Co.
As Representative of the several Underwriters
named in Schedule I hereto
25 Broad Street
New York, New York 10004

Dear Sirs:

The undersigned, Texas International Speedway, Inc., a Texas corporation (the "Company"), hereby confirms its agreement with you as follows.

SECTION 1. *Underwriters and Representative.* The term "Underwriters", as used herein, shall mean the several parties named in Schedule I hereto, including you in your individual capacity as one of such parties, and any underwriter substituted as provided in Section 13 hereof. The term "Representative", as used herein, shall mean you in your capacity as representative of and agent for the several Underwriters, including you in your individual capacity as

one of the Underwriters, and, whether or not so expressed, the personal pronoun "you", when used herein, shall refer to you in your capacity as representative of and agent for the several Underwriters unless the context expressly indicates that such pronoun refers to you in your individual capacity, whether as an Underwriter or otherwise. By signing this Agreement, you confirm that you have been authorized by the Underwriters to execute this Agreement on their behalf and to act for them in the manner herein provided. Whether or not so expressed, all obligations of the Underwriters herein are several in accordance with their respective interests, and not joint, and nothing herein contained shall constitute the Underwriters co-partners of one another.

SECTION 2. *Description of Stock and Units.* When the Registration Statement (hereinafter described) becomes effective and at the Closing Date (hereinafter described), the Company's authorized capital stock shall consist of 2,500,000 shares of Common Stock, par value $1.00 (the "Common Stock"), of which, exclusive of the 330,000 shares of the Common Stock to be sold hereunder by the Company to the Underwriters, there shall be issued and outstanding an aggregate of 433,500 shares, of the Common Stock, plus the number of such shares issued subsequent to May 31, 1969 and prior to the Closing Date pursuant to the exercise of the option referred to in the Prospectus (hereinafter described). The Company has duly authorized by all necessary corporate action, and proposes to issue and sell to the several Underwriters, 3,300 units (the "Units"), each Unit consisting of one $1,000 8% Participating Subordinated Debenture due October 15, 1984 and 100 shares of the Common Stock. The 330,000 shares of the Common Stock and the $3,300,000 8% Participating Subordinated Debentures due October 15, 1984

constituting the Units, which are the subject matter of this Contract, are hereinafter called the "Stock" and the "Debentures", respectively. The Debentures are to be issued under an Indenture (the "Indenture"), dated as of October 15, 1969, between the Company and National Bank of Commerce of Dallas (of Dallas, Texas), as Trustee (the "Trustee"), the form of which has heretofore been filed as an exhibit to the Registration Statement.

SECTION 3. *Representations and Warranties and Agreements of the Company.* The Company represents and warrants to and agrees with the several Underwriters that:

(a) A registration statement (File No. 2-33510) relating, among other things, to the Units, and the Debentures and the Stock included therein, including a form of prospectus, has been carefully prepared by the Company in conformity with the Securities Act of 1933, as amended (the "Securities Act"), the Trust Indenture Act of 1939, as amended (the "Trust Indenture Act"), and the rules, regulations and instructions (the "Rules and Regulations") of the Securities and Exchange Commission (the "Commission") under said Acts, and has been filed with the Commission, and all necessary amendments to such registration statement, including a final form of prospectus, have been, or subject to the provisions of Section 8(a) hereof, will be, filed with the Commission. Copies of said registration statement and amendments thereof and of each related preliminary prospectus (a "Preliminary Prospectus") and the final prospectus have been or will be delivered to you. Said registration statement and prospectus, as amended at the time said registration statement becomes effective, are hereinafter respectively called the "Registration Statement" and the "Prospectus".

(b) When the Registration Statement becomes effective, it and the Prospectus, and on the Closing Date, the Prospectus (as amended or as supplemented if the Company shall have filed with the Commission any amendment thereof or supplement thereto), will comply with the provisions of the Securities Act, the Trust Indenture Act and the Rules and Regulations, will contain all statements which are required to be stated therein in accordance with said Acts and the Rules and Regulations and will not contain an untrue statement of a material fact and will not omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading; *provided, however*, that none of the representations and warranties in this subsection (b) contained shall extend to any Underwriter in respect of (i) any statements in or omissions from the Registration Statement or the Prospectus based on information furnished in writing to the Company by you on behalf of such Underwriter specifically for use in connection with the preparation of the Registration Statement, any Preliminary Prospectus or the Prospectus or (ii) that part of the Registration Statement constituting the Statement of Eligibility and Qualification under the Trust Indenture Act (Form T-1) of the Trustee.

(c) The Company does not, and at the Closing Date will not, have any subsidiaries. The Company has been duly incorporated, and is now, and at the Closing Date will be, validly existing as a corporation in good standing under the laws of the State of Texas, with full power and authority (corporate and other) to own and operate its properties and to carry on its business as and in the places where such properties are owned and operated and such business is conducted, as described in the Registration Statement and the Prospectus; and the Company is, and at the Closing

Date will be, duly qualified to do business as a foreign corporation in good standing in all of the jurisdictions in which it owns or leases properties or in which the conduct of its business requires such qualification.

(d) The financial statements, together with the related schedules and notes, set forth in the Registration Statement and the Prospectus fairly present the financial position and the related cash receipts and disbursements of the Company and the pro forma financial position of the Company at the stated dates and for the periods to which they apply; such financial statements have been prepared in accordance with generally accepted accounting principles consistently applied; and Messrs. Herman & MacLean, who have certified certain portions of such financial statements, are independent accountants as required by the Securites Act and the Rules and Regulations. No financial statements are required to be included in the Registration Statement and the Prospectus which have not been so included.

(e) Subsequent to the respective dates as of which information is given in the Registration Statement and the Prospectus and prior to the Closing Date, except as contemplated in the Registration Statement and the Prospectus, (i) the Company has not incurred and will not have incurred any liabilities or obligations, direct or contingent, or entered into any transactions, not in the ordinary course of business, and (ii) there has not been and will not have been any change in the capitalization of the Company or any material adverse change in the condition (financial or other) of the Company or in the earnings of the Company or in the value of the assets of the Company, whether or not arising from transactions in the ordinary course of business.

(f) The real and personal properties of the Com-

pany, as shown in the Registration Statement and the Prospectus, are, and at the Closing Date will be, either (i) owned by the Company by good and marketable title, free and clear of all liens, encumbrances and restrictions not expressly referred to in the Registration Statement and the Prospectus, except those which do not materially adversely affect the use or value of such assets and except the lien of current taxes not now or then due or (ii) held by the Company under valid and subsisting lease, none of which is in default. The Company in all material respects has, and at the Closing Date will have, full right to maintain and operate its business and properties and is, at the Closing Date will be, complying with all laws, ordinances and regulations applicable thereto.

(g) Except as disclosed in the Registration Statement and the Propsectus, the Company does not, and at the Closing Date will not, have any material contingent obligations, and neither any of the properties nor the business of the Company is, or at the Closing Date will be, subject to any material risks which may be reasonably anticipated.

(h) Except as disclosed in the Registration Statement and Prospectus, there are no actions, suits or proceedings at law or in equity pending, or to its knowledge threatened, against the Company required to be disclosed in the Registration Statement and the Prospectus, and there are no proceedings pending, or to the knowledge of the Company threatened, against the Company before or by any federal or state commission, regulatory body, administrative agency or other governmental body, domestic or foreign, wherein an unfavorable ruling, decision or finding would materially adversely affect the business, franchises, licenses, permits, operations or financial condition or income of the Company.

(i) The Company has the power and authority to

execute and deliver the Indenture and the Warrant (hereinafter described) and to authorize, issue and sell the Debentures and to authorize and issue the Warrant on the terms and conditions set forth herein and in the Indenture or in the Warrant as the case may be, and has taken all corporate action necessary therefor; no consent, approval, authorization or other order of any regulatory authority is required for such execution, delivery, authorization, issue or sale, except as may be required under the Securities Act, the Trust Indenture Act and the so-called Blue Sky laws; when issued and delivered in accordance with the terms of this Agreement, the Debentures and the Warrant will constitute the valid, binding and legally enforceable obligations of the Company (subject to laws of general application affecting the rights of creditors) and the Debentures will be entitled to the benefits of the Indenture; at the Closing Date, the Indenture will conform to the requirements of the Securities Act and the Rules and Regulations, the Indenture and the Warrant will be substantially in the forms filed as exhibits to the Registration Statement, the Indenture will also conform to the requirements of the Trust Indenture Act, the Trustee will be qualified to act as such under the Trust Indenture Act and the Warrant will be exercisable in accordance with its terms.

(j) The outstanding shares of the Common Stock have been duly and validly issued and are fully paid and non-assessable, and the Common Stock, including the Stock and the shares of the Common Stock to be issued upon exercise of the Warrant, conforms, and when the Registration Statement becomes effective and at the Closing Date, will conform, in substance to all statements with regard thereto contained in the Registration Statement and the Prospectus; the issuance and sale of the Stock has been duly and validly authorized and, when the Stock is issued and delivered in accordance with the terms of this

Agreement, all of the outstanding shares of the Common Stock, including the Stock, will be duly and validly authorized and issued, fully paid and non-assessable; and the shares of the Common Stock to be issued upon exercise of the Warrant will have been duly and validly authorized and reserved for issuance and, when so issued in accordance with their respective terms, will be duly and validly issued and outstanding, fully paid and non-assessable.

(k) The execution and delivery by the Company of each of this Agreement, the Indenture and the Warrant has been duly authorized by all necessary corporate action, this Agreement is a valid, binding and legally enforceable obligation of the Company and at the Closing Date each of the Indenture and the Warrant will be a valid, binding and legally enforceable obligation of Company.

(l) Neither the execution and delivery of each of this Agreement, the Indenture and the Warrant nor the consummation of the transactions herein and therein contemplated nor compliance with the terms hereof and thereof by the Company will conflict with or constitute a default under any indenture, mortgage, deed of trust, purchase agreement or other agreement or instrument to which the Company is now a party, or the Articles of Incorporation, as amended, or the By-Laws, as amended, of the Company, or any law, order, rule or regulation, writ, injunction or decree of any government, governmental instrumentality or court, domestic or foreign, having jurisdiction over the Company or over the properties of the Company.

(m) The certificate or certificates required to be furnished to the Underwriters pursuant to the provisions of Sections 11(i) and 11(k) hereof, will be true and correct.

(n) The Company will apply the proceeds from the sale of the units to the purposes set forth in the Registration Statement and the Prospectus.

SECTION 4. *Purchase, Sale and Delivery of the Units; Closing Date.* The Company shall sell to each Underwriter the total number of Units to be purchased by such Underwriter, as set forth opposite the name of such Underwriter in Schedule I hereto, and each Underwriter, on the basis of the foregoing representations and warranties but subject to the terms and conditions of this Agreement, shall purchase such Units from the Company, at and for a price of $1,205.45 per Unit. It is understood that, in making this Agreement, the Underwriters are contracting severally and not jointly and that their several commitments to purchase Units on the basis of the agreements and representations herein contained shall be several and not joint. Except as hereinafter set forth in Section 13 hereof, no Underwriter shall be obliged to purchase more than the number of Units set forth opposite its name in Schedule I hereto.

Delivery of the Debentures and the Stock constituting the Units shall be made to or upon your order, as Representative for the respective accounts of the several Underwriters, at your office, 25 Broad Street, New York, New York 10004, against payment by you to the Company, for the account of the several Underwriters, of the purchase price of the Units purchased by the several Underwriters from the Company by certified or bank cashier's checks, payable in New York Clearing House funds to the order of the Company, at 10:00 A.M., New York City Time, on November 7, 1969, or at such other time on such day or such time on such other business day (Saturdays not being considered business days for the purposes of this Agreement), not later than the tenth calendar day (or the business day next following such tenth calen-

dar day if such tenth calendar day shall not be a business day) following the date upon which the Registration Statement becomes effective (except as extended beyond such tenth day pursuant to Section 13 hereof), as you shall determine and advise the Company in writing by at least two full business days' notice, which time and date are herein called the "Closing Date". Delivery of the Debentures and the Stock constituting the Units shall be made in registered form in such name or names and in such denominations as you shall request by at least two full business days' notice in writing. The cost of original issue tax stamps, if any, in connection with the issuance and delivery of the Debentures and the Stock constituting the Units by the Company to the several Underwriters or their nominees shall be borne by the Company; and the cost of any transfer tax stamps involved in any sale or transfer by any Underwriter or its nominee shall be borne by such Underwriter. The Company will pay and save the Underwriters, and any subsequent holder of the Debentures or the Stock, harmless from any and all liabilities with respect to or resulting from any failure or delay in paying federal and state stamp taxes, if any, which may be payable or determined to be payable in connection with the sale and delivery to the several Underwriters of the Debentures and the Stock constituting the Units.

You, in your individual capacity, and not as Representative of the several Underwriters, may (but shall not be obligated to) make the payment to the Company for the account of any Underwriter or Underwriters whose check or checks shall not have been received by you, as Representative, at the Closing Date.

The Company will make the Debentures and the Stock constituting the Units available to you for examination on behalf of the Underwriters at your offices, not later than

2:00 P.M., New York City Time, on the business day next preceding the Closing Date.

SECTION 5. *Offering of Units.* The several Underwriters propose to offer the Units to the public upon the term set forth in the Prospectus as soon after the Registration Statement becomes effective as practicable at an initial offering price of $1,333 per Unit.

SECTION 6. *Warrant.* In order to induce you, in your individual capacity, and not as Representative of the several Underwriters, to enter into this Agreement, the Company, without additional consideration, shall execute and deliver to you, in your individual capacity and not as Representative of the several Underwriters, a five-year warrant (herein called the "Warrant") to purchase 23,000 shares of the Common Stock at the exercise price of $4.00 per share. The Warrant shall be in the form of Exhibit 1(d) to the Registration Statement. Delivery of the Warrant registered in your name, shall be made at your office, 25 Broad Street, New York, New York 10004, on the Closing Date. The cost of original issue tax stamps, if any, in connection with the execution and delivery of the warrant shall be in your name, shall be borne by the Company.

SECTION 7. *Registration Statement and Prospectus.* The Company will furnish and deliver to you, without charge four signed copies (only two of which shall include exhibits) of the Registration Statement and of each amendment thereof or supplement thereto, including all financial statements and exhibits thereto and signed certifications and consents contained therein, and the number of conformed copies of the Registration Statement and of each amendment thereof or supplement thereto, including all financial statements, but excluding exhibits, as you may reasonably request.

The Company has delivered to the several Underwriters and to others whose names and addresses have been supplied by you, without charge, copies of each Preliminary Prospectus filed with the Commission in accordance with and pursuant to the Commission's Rule 433. The Company will furnish and deliver to the several Underwriters and to others whose names and addresses are supplied by you, without charge, on the effective date of the Registration Statement, and thereafter from time to time during the period of ninety days after the date of the initial public offering of the Units (or for such longer reasonable period as you may request, if in the opinion of Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, the Prospectus is required by law to be delivered in connection with sales by an Underwriter or a dealer after the expiration of such period of ninety days), as many copies of the Prospectus (and in the event of any amendment of or supplement to the Prospectus, of such amended or supplemented Prospectus) as you may reasonably request for the purposes contemplated by the Securities Act. If during such period any event known to the Company relating to or affecting the Company shall occur which should be set forth in an amendment of or a supplement to the Prospectus in order that it will not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading in the light of the circumstances when it is delivered to a purchaser or a prospective purchaser, or it shall be necessary to amend or supplement the Prospectus to comply with law or with the Rules and Regulations, the Company will forthwith prepare, furnish and deliver to the several Underwriters and to others whose names and addresses are supplied by you, without charge, a reasonable number of copies of the amendment or amend-

ments of or supplement or supplements to the Prospectus which will so amend or supplement the Prospectus that as amended or supplemented it will not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading in the light of the circumstances when it is delivered to a purchaser or prospective purchaser and which will comply with law and with the Rules and Regulations.

The Company authorizes the Underwriters and all dealers selected by you in connection with the distribution of the Debentures and the Stock constituting the Units and all dealers to whom any of the Debentures and the Stock constituting the Units may be sold by any Underwriter or by any such selected dealer, to use the Prospectus, as from time to time amended or supplemented, in connection with the sale of the Debentures and the Stock constituting the Units in accordance with the applicable provisions of the Securities Act and the applicable Rules and Regulations and applicable state law.

SECTION 8. *Covenants of the Company.* The Company covenants and agrees with the several Underwriters that:

(a) After the date hereof, the Company will not, at any time, whether before or after the effective date of the Registration Statement, file any amendment thereof or supplement thereto of which you shall not previously have been advised and furnished with a copy, or which you or Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, shall not have approved in writing, which approval shall not be unreasonably withheld or withheld for reasons not material, or which is not in compliance with the Securities Act, the Trust Indenture Act or the Rules and Regulations.

(b) The Company will use its best efforts to cause the Registration Statement to be come effective and will promptly advise you, and confirm such advice in writing, (i) when the Registration Statement shall have become effective and when any post-effective amendment thereof shall have become effective, and when any amendment of or supplement to the Prospectus shall be filed with the Commission, (ii) when the Commission shall make a request or suggestion for any amendment to the Registration Statement or the Prospectus or for additional information and the nature and substance thereof and (iii) of the issuance by the Commission of a stop order suspending the effectiveness of the Registation Statement or of the initiation of any proceeding for that purpose, and will use every reasonable effort to prevent the issuance of such a stop order, or, if such an order shall be issued, to obtain the withdrawal thereof at the earliest possible moment.

(c) The Company will carefully prepare and file with the Commission, upon your request, any such amendments of or supplements to the Registration Statement or Prospectus in form satisfactory to Messrs. Scholl, Jenkins, Robinson & Stieg, special counsel for the Company, as in the opinion of Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, may be necessary or advisable in connection with the distribution of the Debentures and the Stock constituting the Units and/or any change in the price at which, or the terms upon which, each Unit may be offered by the Underwriters; and the Company will use its best efforts to cause the same to become effective as promptly as possible.

(d) The Company will prepare and file with the securities administrators or commissions of such jurisdictions as you shall designate, when and as requested by you, all necessary documents, exhibits, information, applications and instruments, and will execute all such applications and instruments, as may be required or desirable in the opinion of Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, to qualify the Debentures and the Stock constituting the Units for offering and sale under the so-called Blue Sky laws of such jurisdictions and to continue such qualification in effect so long as required for the purpose of the distribution of the Debentures and the Stock constituting the Units; *provided, however,* that the Company shall not be required to qualify as a foreign corporation or to file a consent to service of process in any jurisdiction in any action other than one arising out of the offering or sale of the Debentures and the Stock constituting the Units.

(e) During the period of five years from the effective date of the Registration Statement, the Company will deliver to you, as soon as available, in such number of copies as you may reasonably request, (i) each annual report of the Company and every other report (financial or other) mailed to its stockholders, (ii) within 90 days after the end of each fiscal year of the Company, a balance sheet of the Company as at the end of such fiscal year, together with statements of income and retained earnings of the Company for such fiscal year, all to be in complete detail and accompanied by a certificate or report of independent certified public accountants (who may be the regular accountants for the Company), (iii) within 45 days

after the end of each of the first three fiscal quarters of each fiscal year, similar statements of income for the fiscal quarter then ended, and, in the case of the second and third such fiscal quarters, for such fiscal year to the end of such fiscal quarter, all to be in complete detail and certified by the Company's principal financial officer or the Company's principal accounting officer, (iv) as soon as available, every report and financial statement furnished to or filed with any securities exchange or the Commission pursuant to requirements by or agreements with such exchange or with the Commission and (v) such other material as you may from time to time reasonably request regarding the financial condition and operations of the Company. The financial statements required by the foregoing clauses (ii) and (iii) shall, subsequent to the Company's fiscal year ending in 1970, state comparative figures for the preceding year or the same quarter of the preceding year or the portion of the preceding year elapsed at the end of the same quarter of the preceding year, as the case may be, and shall be furnished on a consolidated basis in respect of the Company and all, if any, of its subsidiaries the accounts of which are consolidated with those of the Company, and separate financial statements shall be furnished for each subsidiary, if any, of the Company the accounts of which are not so consolidated.

(f) The Company will make generally available to its security holders as soon as practicable, and in any event within sixteen months after the effective date of the Registration Statement, an earnings statement of the Company (which will be in reasonable detail, but need not be audited) covering a period of twelve months commencing after the effective date of the

Registration Statement. Such earnings statement shall comply with the requirements of Section 11(a) of the Securities Act and all Rules and Regulations in effect at the time of the issuance thereof.

(g) The Company will pay all fees, taxes and expenses incident to the performance of the obligations of the Company under this Agreement, including, but not limited to, expenses and taxes incident to the preparation, execution and delivery of the Indenture, expenses and taxes incident to the issuance and delivery to the several Underwriters of the Debentures and the Stock constituting the Units, fees and expenses of counsel and accountants for the Company, expenses incident to the preparation, printing and filing under the Securities Act and the Trust Indenture Act of the Registration Statement (including all exhibits thereto), each Preliminary Prospectus and the Prospectus and any amendments thereof or supplements thereto, including furnishing copies to the Underwriters and others as herein provided, and the fees and expenses incident to the qualification for offering and sale of the Debentures and the Stock constituting the Units under the so-called Blue Sky laws. The Company will pay you the sum of $25,000 as a non-accountable allowance for expenses, other than the expenses referred to in the next succeeding sentence of this subsection (g), which may be incurred by you in connection with this Agreement and the offering of the Units. The Company will also reimburse you for all fees and expenses which may be incurred by you in connection with the qualification for sale of the Debentures and the Stock constituting the Units under the so-called Blue Sky laws and the preparation, execution and delivery of the Indenture, in-

cluding the reasonable fees and disbursements of counsel for the Underwriters incurred in connection therewith. The foregoing payments shall be made by the Company, whether or not the transactions contemplated in this Agreement are consummated and whether or not this Agreement shall become effective as provided in Section 10 hereof; *provided, however,* that if the Debentures and the Stock constituting the Units shall not be sold to the Underwriters as contemplated in this Agreement and either you shall have prevented this Agreement from becoming effective pursuant to Section 12(a) hereof or this Agreement shall have terminated pursuant to Section 12(c) hereof, or the Company and the Underwriters referred to in Section 13 hereof shall be relieved of all obligations under this Agreement pursuant to said Section 13, the Company shall not be required to make the payments referred to in the second and third sentences of this subsection (g). If the Debentures and the Stock constituting the Units shall not be sold to the Underwriters as contemplated in this Agreement and either this Agreement shall have been terminated pursuant to Section 12(b) hereof or the Company shall have prevented this Agreement from becoming effective pursuant to Section 12(a) hereof, the Company will also pay or cause to be paid the reasonable fees and disbursements of counsel for the Underwriters in connection with the transactions contemplated in this Agreement. Except as otherwise provided in this subsection (g), the Underwriters shall pay the fees and disbursements of their counsel. The foregoing will not require the Company to pay the cost of any transfer tax stamps on sales of Debentures and/or Stock made by any Underwriter.

(h) The Company will comply with all of the provisions of the Undertakings set forth in the Registration Statement.

SECTION 9. *Indemnification.* (a) The Company agrees to indemnify and hold harmless each Underwriter and each person who controls any Underwriter within the meaning of Section 15 of the Securities Act against any and all losses, claims, damages or liabilities, joint or several, to which they or any of them may become subject under the Securities Act, the Trust Indenture Act or any other statute or at common law and to reimburse all persons indemnified as above for any legal or other expenses (including the cost of any investigation and preparation) incurred by them in connection with any litigation, whether or not resulting in any liability, but only insofar as such losses, claims, damages, liabilities or actions arise out of, or are based upon, any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement or any post-effective amendment thereto or the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, all as of the date when the Registration Statement or such post-effective amendment, as the case may be, becomes effective, or any untrue statement or alleged untrue statement of a material fact contained in any Preliminary Prospectus or the Prospectus (as amended or as supplemented if the Company shall have filed with the Commission any amendments thereof or supplements thereto), or the omission or alleged omission to state therein a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading; *provided, however,* that the

indemnity agreement contained in this subsection (a) shall not apply to amounts paid in settlement of any such litigation if such settlement is effected without the consent of the Company, nor shall it extend to any Underwriter or any person controlling such Underwriter in respect of any such losses, claims, damages, liabilities or actions (i) arising out of, or based upon, any such untrue statement or alleged untrue statement, or any such omission or alleged omission, if such statement or omission was made in reliance upon and in conformity with information furnished in writing to the Company by you on behalf of such Underwriter specifically for use in connection with the preparation of the Registration Statement, any Preliminary Prospectus or the Prospectus or any such amendment thereof or supplement thereto or was contained in that part of the Registration Statement constituting the Statement of Eligibility and Qualification under the Trust Indenture Act (Form T-1) of the Trustee, or (ii) arising out of, or based upon, the failure of any Underwriter or dealer to deliver the Prospectus (as amended or as supplemented if the Company shall have filed with the Commission any amendments thereof or supplements thereto and delivered copies of such amendments or supplements to you) as required by the Securities Act or the Rules and Regulations. Each Underwriter agrees wtihin 10 days after the receipt by it of written notice of any claim or of the commencement of an action against such Underwriter or against any person controlling such Underwriter, as aforesaid, in respect of which indemnity may be sought from the Company on account of the indemnity agreement contained in this subsection (a), to notify the Company in writing thereof. The omission of such Underwriter so to notify the Company of any such action shall relieve the Company from any liability which it may have to such Underwriter or such controlling person on account of the indemnity agreement contained in this subsection (a), but

shall not relieve the Company from any liability which it may otherwise have to such Underwriter or such controlling person or from any liability which it may have to any other Underwriter or any controlling person of any such other Underwriter. In case any such action shall be brought against any Underwriter or any such controlling person and such Underwriter shall notify the Company of the commencement thereof, the Company shall be entitled to participate in (and, to the extent that it shall wish, to direct) the defense thereof at its own expense, but such defense shall be conducted by counsel of recognized standing and reasonably satisfactory to the Underwriter or Underwriters or such controlling person or persons, defendant or defendants in the litigation. The Company agrees to notify you promptly of the commencement of any litigation of proceeding against it or any of the officers or directors of the Company of which it may be advised in connection with the issuance and sale of any of its securities.

(b) Each Underwriter (including each Underwriter substituted as provided in Section 13 hereof) agrees, in the same manner and to the same extent as set forth in subsection (a) of this Section 9, to indemnify and hold harmless the Company, the directors of the Company, the officers of the Company who shall have signed the Registration Statement, and each person, if any, who controls the Company within the meaning of Section 15 of the Securities Act, with respect to any statement in or omissions from the Registration Statement or any post-effective amendment thereto, any Preliminary Prospectus or the Prospectus (as amended or as supplemented, if amended or supplemented as aforesaid), if such statement or omission was made in reliance upon and in conformity with information furnished in writing to the Company by you on behalf of such Underwriter specifically for use in

connection with the preparation of the Registration Statement or the Prospectus or any such amendment thereof or supplement thereto. No Underwriter shall be liable for amounts paid in settlement of any such litigation, if such settlement is effected without its consent. In case of the commencement of any action in respect of which indemnity may be sought from such Underwriter on account of the indemnity agreement contained in this subsection (b), each person agreed to be indemnified by such Underwriter shall have the same obligation, subject to the same loss of indemnity hereunder, to notify such Underwriter as such Underwriter has to notify the Company in subsection (a) of this Section 9, and such Underwriter shall have the same right to participate in (and, to the extent that such Underwriter shall wish, to direct) the defense of such action at its own expense, but such defense shall be conducted by counsel of recognized standing and reasonably satisfactory to the Company. Each Underwriter agrees to notify the Company promptly of the commencement of any litigation or proceeding against it or against any such controlling person of such Underwriter of which it may be advised in connection with the issuance and sale of any securities of the Company.

(c) The respective indemnity agreements of the Company and the Underwriters contained in subsections (a) and (b) of this Section 9, and the covenants, representations, warranties and agreements of the Company set forth elsewhere in this Agreement, shall remain operative and in full force and effect regardless of any investigation made by or on behalf of any Underwriter or any controlling person of any Underwriter or the Company or any such officer or director or controlling person of the Company and shall survive the delivery of the Debentures and the Stock constituting the Units, and any successor of any

Underwriter or of any controlling person of any Underwriter or of the Company or of any controlling person of the Company, as the case may be, shall be entitled to the benefit of the respective indemnity agreements.

SECTION 10. *Effectiveness of Agreement.* This Agreement shall become effective (i) at 11:00 A.M., New York City Time, on the first full business day next following the day on which the Registration Statement becomes effective, or (ii) at the time of the release by you of the Units for offering after the Registration Statement shall have become effective, whichever shall first occur. For the purposes of this Section 10, the time of the release by you of the Units for offering shall mean the time of the release by you for publication of the first newspaper advertisement which is subsequently published relating to the Units, or the time of the mailing to prospective selected dealers of copies of the Prospectus and signed copies of a Selling Agreement relating to the Units which are subsequently delivered, whichever shall first occur. You agree to notify the Company immediately after you have taken any action, by release or otherwise, whereby this Agreement shall have become effective. This Agreement shall, nevertheless, become effective at such time earlier than the time specified above, after the Registration Statement becomes effective, as you may determine in and by notice to the Company.

SECTION 11. *Conditions of the Underwriters' Obligations.* The several obligations of the Underwriters to purchase the Units shall be subject to the accuracy, as of the Closing Date, of the representations and warranties on the part of the Company herein contained, to the performance by the Company of all of its obligations hereunder and to the following additional conditions;

(a) The Registration Statement shall have become effective prior to 6:00 P.M., New York City Time, on October 30, 1969, or such later date as you may approve; on or prior to the Closing Date the Debentures and the Stock constituting the Units shall have been duly qualified for offering and sale to the public under the so-called Blue Sky laws of those jurisdictions which you shall have specified, unless valid exemptions with respect to such offering and sale shall have been obtained therefrom; no stop order suspending the effectiveness of the Registration Statement or the qualification or the exemption of the Debentures and the Stock constituting the Units under the so-called Blue Sky laws of any jurisdiction (whether or not a jurisdiction which you have specified as hereinbefore provided) shall have been issued and no proceeding for that purpose shall have been initiated or shall be threatened by the Commission or the authorities of any jurisdiction; any request for additional information on the part of the Commission or any such authorities shall have beeen complied with to the satisfaction of the Commission and such authorities; and after the date hereof no amendment of the Registration Statement or the Prospectus shall have been filed which you or Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, shall not have approved in writing.

(b) No Underwriter shall have disclosed in writing to the Company that the Registration Statement or the Prospectus or any amendment thereof or supplement thereto contains an untrue statement of a fact which, in the opinion of Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, is material, or omits to state a fact which, in

the opinion of such counsel, is material and is required to be stated therein or is necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

(c) Between the date hereof and the Closing Date, the Company shall not have sustained any loss on account of fire, explosion, flood, accident, calamity of any other cause of such character as materially adversely affects its business or properties, whether or not such loss is covered by insurance.

(d) Between the date hereof and the Closing Date, except as disclosed in the Registration Statement and the Prospectus, there shall be no litigation instituted against the Company involving the reasonable possibility of judgments or liabilities (not insured against) against the Company in any one case in excess of $20,000 or in the aggregate of more than $50,000 and between such dates there shall be no proceeding instituted or threatened against the Company before or by any federal or state court, commission, regulatory body or administrative agency or other governmental body, domestic or foreign, wherein an unfavorable ruling, decision or finding would materially adversely affect the business, operations, financial condition or income of the Company.

(e) Except as contemplated herein or as set forth in the Registration Statement and the Prospectus, during the period subsequent to May 31, 1969, and prior to the Closing Date, (i) the Company shall have conducted its business substantially in the usual and ordinary course of business, shall not have incurred any material liabilities or obligations (direct or contingent), or disposed of any of its assets, or entered

into any material transaction, and (ii) the Company shall not have suffered or experienced any substantially adverse change, financial or otherwise. At the Closing Date, the capital stock and surplus accounts of the Company shall be substantially as great as on May 31, 1969, without considering the proceeds from the sale by the Company of the Debentures and the Stock constituting the Units.

(f) The representations, warranties and agreements of the Company herein contained shall be true and correct at the Closing Date, and all agreements herein contained to be performed on the part of the Company, and all conditions herein contained, or set forth in the Registration Statement and the Prospectus, to be fulfilled or complied with by the Company at or prior to the Closing Date shall have been duly performed, fulfilled or complied with.

(g) On each of the dates of this Agreement and the Closing Date, the Company shall have furnished to you an opinion (addressed to you, as Representative), dated as of such date, of Messrs. Scholl, Jenkins, Robinson & Stieg, special counsel for the Company, to the effect that:

(i) The Company has been duly incorporated and on such date is a validly existing corporation in good standing under the laws of the State of Texas, with full power and authority (corporate and other) to own and operate its properties and to carry on its business as and in the places where such properties are owned and operated and such business is conducted, as described in the Registration Statement and the Prospectus, and the Company has an

authorized and outstanding capitalization as set forth in Section 2 hereof;

(ii) The Company has lawful authority, without licensing or qualifying as a foreign corporation in any jurisdiction, other than the jurisdictions in which it is so duly licensed or qualified, which shall be specified, to own and operate its properties as and in the places where such properties are owned or to conduct its business as now conducted;

(iii) No approval of any public service commission or other governmental or regulatory body, except as may be required under the Securities Act, the Trust Indenture Act and the so-called Blue Sky laws, is necessary in connection with the issuance, sale or delivery by the Company of the Debentures and the Stock constituting the Units to the Underwriters and of the Warrant or in connection with the execution, delivery and carrying out of the provisions of the Indenture, the Warrant and this Agreement by the Company;

(iv) The outstanding shares of the Common Stock, including the Stock, the Debentures and the Warrant conform to all statements with regard thereto contained in the Registration Statement and Prospectus; the issuance, sale and delivery of the shares of the Stock have been duly and validly authorized, and the shares of the Stock delivered on the Closing Date and all previously outstanding shares of the Common Stock are duly and validly issued, fully paid and non-assessable; the Debentures have been duly and validly authorized, executed, authenticated, issued and delivered and constitute the valid, binding and legally enforceable

obligations of the Company entitled to the benefits of the Indenture; the Warrant has been duly and validly authorized, executed, issued and delivered and constitutes the valid, binding and legally enforceable obligation of the Company in accordance with its terms; and the shares of the Common Stock to be issued upon exercise of the Warrant have been duly and validly authorized and reserved for issuance and, when so issued in accordance with their respective terms, will be duly and validly issued and outstanding, fully paid and non-assessable;

(v) Each of this Agreement and the Indenture has been duly authorized, executed and delivered and constitutes a valid, binding and legally enforceable obligation of the Company;

(vi) The real and personal properties of the Company are either (1) owned by the Company by good and marketable title, free and clear of all liens, encumbrances and restrictions, except those expressly referred to in the Registration Statement, except those which do not in the opinion of such counsel materially adversely affect the use or value of such assets and except the lien of current taxes not now due, or (2) held by the Company under valid leases;

(vii) The Registration Statement and the Prospectus comply as to form in all material respects with the requirements of the Securities Act, the Trust Indenture Act and the Rules and Regulations (except that no opinion need be expressed as to financial statements and other financial data contained in the Registration Statement or the Prospectus), the Indenture conforms to the requirements of the Trust

Indenture Act and the Rules and Regulations and the Trustee is qualified to act as such under the Trust Indenture Act, and such counsel has no reason to believe that either the Registration Statement or the Prospectus contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances in which they are made, not misleading, and such counsel is familiar with all contracts referred to in the Registration Statement or in the Prospectus as required, and such counsel does not know of any contracts required to be summarized, disclosed or filed which have not been summarized, disclosed or filed; and

(viii) Such counsel does not know and has no reason to believe that the representations, warranties and agreements of the Company contained in Sections 3(h) and 3(l) hereof and the last sentence of Section 3(f) hereof are not true and correct.

Such opinion shall also cover such other matters incident to the transactions contemplated by this Agreement as you may reasonably request and you shall be furnished without charge, in addition to the original signed copies, such number of signed or photostatic or conformed copies as you shall reasonably request. It is understood that Messrs. Scholl, Jenkins, Robinson & Stieg, in giving their opinion pursuant to this Section 11(g), may rely, to the extent they deem appropriate, upon an opinion or opinions of Messrs. Witts, Lee, Pletcher & Douglass, of Dallas, Texas, as to matters of Texas law.

(h) On each of the date of this Contract and the Closing Date, Messrs. Herman & MacLean shall have furnished to you a letter, dated as of such date, addressed to you and to us, in form and substance satisfactory to you, to the effect that:

(i) Such accountants are independent accountants as required by the Securities Act and the Rules and Regulations;

(ii) In the opinion of such accountants the financial statements and the related schedules and notes examined by them which are included in the Registration Statement and the Prospectus comply as to form in all material respects with the applicable accounting requirements of the Securities Act and the Rules and Regulations relating to financial statements;

(iii) On the basis of a limited review, but not an audit, of the financial data and accounting records of the Company, inquiries of responsible officers of the Company, a review of the minutes of the meetings of the shareholders and the Board of Directors of the Company and other specific inquiries, which limited review and inquiries do not constitute an examination made in accordance with generally accepted auditing standards, and accordingly are not adequate to enable them to express an opinion with respect to any financial statements or transactions of the Company subsequent to May 31, 1969, nothing has come to the attention of such accountants which in their opinion would indicate (A) that the financial statements and the related schedules and notes not examined by them which are included in the Registration Statement and the Pro-

spectus do not comply as to form in all material respects with the applicable accounting requirements of the Securities Act and the Rules and Regulations relating to financial statements or were not prepared in accordance with generally accepted accounting principles and practices applied on a basis consistent in all material respects with the audited financial statements and the related schedules and notes so included or do not fairly present the information purported to be shown or that any material adjustments are required or that any adjustments other than normal recurring accruals have been reflected therein or (B) that during the period from May 31, 1969 to a specified date, not more than five days prior to the date of such letter, there has been a material change in the capitalization of the Company or any material adverse change in the financial position or the results of operations of the Company, except as set forth or contemplated in the Registration Statement and the Prospectus; and

(iv) Neither the examination referred to in the report of such accountants included in the Registration Statement and the Prospectus nor the actions taken by such accountants which are referred to in paragraph (iii) of this subsection (h) caused them to believe that any adjustment for a fair presentation of the information purported to be shown is required in (A) the financial and accounting information appearing in Item 25 of the Registration Statement (insofar as it relates to sales of capital stock and long-term debt by the Company), in answer to Item 26 thereof (insofar as it relates to sales of capital stock and long-term debt and exclusive of subparagraph (d) of such Item), in answer to Item 27 thereof, in

answer to Item 30 thereof or in answer to Item 31(a) thereof or (B) the dollar-amounts, percentages and other figures set forth in the Registration Statement and the Prospectus under the captions Introductory Statement, Use of Proceeds, Capitalization, History and Business, Plant and Property and Financial Statements.

(i) You shall have received on the Closing Date a certificate, dated that date, signed by the President and Treasurer and the Executive Vice President of the Company, to the effect that:

(i) Each signer of such certificate has carefully examined the Registration Statement and the Prospectus and that (1) as of the effective date of the Registration Statement, the statements in the Registration Statement and the Prospectus were true and correct and neither the Registration Statement nor the Prospectus omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, (2) since the effective date of the Registration Statement, no event has occurred which was required by the Securities Act or the Rules and Regulations to be set forth in a supplement to or amendment of the Prospectus but which has not been so set forth and (3) since the respective dates as of which or periods for which information is given in the Registration Statement and the Prospectus, there has not been any material adverse change in the condition of the Company, financial or otherwise, or in the earnings of the Company, from that set forth in the Registration Statement and the Prospectus, whether or not arising in the ordinary course of

business, other than changes which the Registration Statement and the Prospectus indicate might occur after the effective date of the Registration Statement;

(ii) No stop order suspending the effectiveness of the Registration Statement has been issued and no proceedings for such purpose have been taken or are, to the knowledge of each signer of such certificate, contemplated by the Commission;

(iii) The conditions, separately set forth in such certificate, contained in subsections (c), (d), (e) and (f) of this Section 11 have been complied with.

(j) All corporate proceedings and other legal matters relating to the issuance, delivery and sale of the Debentures and the Stock constituting the Units, the Warrant, this Agreement, the Indenture, the Registration Statement, the Prospectus and other related matters shall be reasonably satisfactory in all material respects to Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters, and the Company shall have furnished to such counsel such records and documents as they may have reasonably requested in a timely manner for the purpose of enabling them to pass upon such matters.

(k) The Company shall have furnished to you such certificates, additional to those specifically mentioned herein, as you may have reasonably requested in a timely manner as to the accuracy and completeness, at the Closing Date, of any statement in the Registration Statement or the Prospectus, as to the accuracy, at the Closing Date, of the representations, warranties and agreements of the Company herein, as to the

performance by the Company of its obligations hereunder or as to the fulfillment of the conditions concurrent and precedent to the obligations of the Underwriters hereunder.

All of the opinions, letters, evidence and certificates mentioned above or elsewhere in this Agreement shall be deemed to be in compliance with the provisions hereof only if they are in form and substance reasonably satisfactory to Messrs. Rosenman Colin Kaye Petschek Freund & Emil, counsel for the Underwriters.

You reserve the right to waive any condition hereinabove set forth.

SECTION 12. *Effective Date and Termination.* (a) This contract may be prevented from becoming effective by the Company by notice to you, or by you by notice to the Company, at any time before the effective time of this Contract as set forth in Section 10 hereof.

(b) This Agreement may be terminated by you by notice to the Company at any time prior to delivery of any payment for the Units in the event that at or prior to the Closing Date the Company shall have failed or been unable to comply with any of the provisions of this Agreement on its part to be performed or complied with at or prior to such time, or if any of its conditions, representations, warranties, covenants or agreements herein contained (including, but not limited to, those contained in Sections 8 and 11 hereof) shall not have been complied with, satisfied, fulfilled or performed within the respective times herein provided unless such compliance, satisfaction, fulfillment or performance shall have been expressly waived by you in writing.

(c) This Agreement may be terminated by you by notice

to the Company at any time at or prior to the Closing Date if, in your judgment, payment for and delivery of the Units is rendered impracticable or inadvisable because (i) additional material governmental restrictions, not in force and effect on the date hereof, shall have been imposed upon trading in securities generally or minimum or maximum prices shall have been generally established on the New York Stock Exchange or trading in securities generally on such Exchange shall have been suspended or a general banking moratorium shall have been established by Federal or New York State authorities, or (ii) a presently non-existing war or other calamity shall have occurred, or (iii) there has been a substantial adverse change in general market or economic conditions from such conditions on the date hereof.

(d) If this Agreement shall be prevented from becoming effective pursuant to subsection (a) of this Section 12 or if this Agreement shall be terminated pursuant to subsections (b) or (c) of this Section 12, such action shall be without liability of any character (including, but not limited to, loss of anticipated profits or consequential damages) on the part of any party hereto, except that, if this Agreement shall be prevented from becoming effective by the Company pursuant to said subsection (a) or shall be terminated pursuant to said subsection (b), the Company shall remain obligated for the payment of all costs, fees, taxes and expenses provided to be paid by it in Section 8(g) hereof.

SECTION 13. *Substitution of Underwriters.* If any one or more Underwriters shall for any reason fail to take up and pay for the Units to be purchased by it or them in accordance with the terms hereof, the remaining Underwriters shall have the right either to take up and pay for (in such proportion as may be agreed upon among them), or to

substitute another underwriter or underwriters (who shall be a member or members in good standing of the National Association of Securities Dealers, Inc.) to take up and pay for, the Units which the defaulting Underwriter or Underwriters agreed but failed to purchase; *provided, however,* in the event that not all of the Units which the defaulting Underwriter or Underwriters agreed but failed to purchase shall be so taken up and paid for, the non-defaulting Underwriters shall be obligated to take up and pay for up to 330 Units on the terms herein set forth in proportion to their respective obligations hereunder or as they shall otherwise agree among themselves. In the event the non-defaulting Underwriters shall not take up and pay for all of the Units which the defaulting Underwriter or Underwriters agreed but failed to purchase or substitute another underwriter or underwriters who shall take up and pay for all of such Units within 24 hours after such failure, the Company shall have the right (if not in default hereunder), during an additional period of 24 hours after such failure, to find another underwriter or underwriters (who shall be a member or members in good standing of the National Association of Securities Dealers, Inc.) who shall be reasonably acceptable to you to take up and pay for the Units which the defaulting Underwriter or Underwriters agreed but failed to purchase and which shall not be so taken up and paid for. If neither the non-defaulting Underwriters nor the Company shall find another underwriter to take up and pay for the Units which the defaulting Underwriter or Underwriters agreed but failed to purchase and which shall not be so taken up and paid for, neither the Company nor the non-defaulting Underwriters shall be under any obligation under this Agreement. If a new underwriter is substituted by the non-defaulting Underwriters or by the Company for the defaulting Underwriter or Underwriters under the forego-

ing provisions, the Company or the Underwriters shall have the right to postpone the Closing Date for a period of not exceeding seven full business days in order that necessary changes in the Registration Statement and the Prospectus and other documents may be effected. Except as otherwise set forth in this Section 13, nothing herein shall obligate any Underwriter to purchase or find underwriters for more than the Units to be purchased by it as set forth opposite its name in Schedule I hereto; nor shall anything herein be construed to relieve any defaulting Underwriter of its liabilities or obligations to the Company and the non-defaulting Underwriters and the consequence of its default.

SECTION 14. *Notice.* Except as otherwise expressly provided in this Agreement, (a) whenever notice or an objection, designation, request or report is given or is required by the provisions of this Agreement to be given to the Company, such notice, objection, designation, request or report shall be in writing addressed to the Company at 2990 West Grand Boulevard, Detroit, Michigan 48202, with a copy to Messrs. Scholl, Jenkins, Robinson & Stieg, 1051 Penobscot Building, Detroit, Michigan 48226 and (b) whenever notice or an objection, designation, request or report is given or is required by the provisions of this Agreement to be given to you, either in your capacity as Representative or in your individual capacity, such notice, objection, designation, request or report shall be in writing addressed to you at 25 Broad Street, New York, New York 10004, with a copy to Messrs. Rosenman Colin Kaye Petschek Freund & Emil, 575 Madison Avenue, New York, New York 10022.

SECTION 15. *Miscellaneous.* This Agreement is made solely for the benefit of the several Underwriters, the Company, the Company's directors, the Company's of-

ficers who shall have signed the Registration Statement, and any controlling person referred to in Section 9 hereof, and their respective successors and assigns, and no other person shall acquire or have any right under or by virtue of this Agreement. The term "successor" or the term "successors and assigns" as used in this Agreement shall not include any buyer, as such, of any of the Debentures and the Stock constituting the Units from any of the Underwriters. This Agreement shall supersede any agreement or understanding, oral or in writing, express or implied, between the Company and you relating to the sale of the Debentures and the Stock constituting the Units. Please confirm that the foregoing correctly sets forth the agreement between the Company and you.

Very truly yours,

TEXAS INTERNATIONAL SPEEDWAY, INC.

By /s/
President

We hereby confirm as of the date thereof the above letter correctly sets forth the agreement between the Company and the several Underwriters.

LADENBURG, THALMANN & CO.
As Representative

By /s/
Authorized Signature

SCHEDULE I

Name of Underwriter	Address of Underwriter	Number of Units to be Purchased
Ladenburg, Thalmann & Co.	25 Broad Street New York, N.Y. 10004	1,070
Black & Company, Inc.	300 American Bank Bldg. Portland, Oregon 97205	50
D.H. Blair & Company	66 Beaver Street New York, New York 10004	30
Boettcher and Company	828 17th Street Denver, Colorado 80202	50
Butcher & Sherrerd	1500 Walnut Street Philadelphia, Pennsylvania 19102	125
James C. Butterfield, Inc.	297 West Michigan Avenue Jackson, Michigan 49201	30
Buttonwood Corporation	4051 Penobscot Bldg. Detroit, Michigan 48226	30
Cogan, Berlind, Weill & Levitt, Inc.	767 Fifth Avenue New York, N.Y. 10022	125
Devon Securities	60 East 56th Street New York, N.Y. 10022	30
Edwards & Hanley Securities, Inc.	55 Broad Street New York, N.Y. 10004	30
Emanuel Deetjen & Co.	120 Broadway New York, N.Y. 10005	30
First of Michigan Corporation	Buhl Building Detroit, Michigan 48226	125
First Mid America Corporation	1001 "O" Street Lincoln, Nebraska 68501	30
Freehling & Co.	120 South LaSalle Street Chicago, Illinois 60603	50
H. Hentz & Co.	72 Wall Street New York, N.Y. 10005	125
Hertz, Warner & Co.	Two Broadway New York, New York 10004	30
Herzfeld & Stern	30 Broad Street New York, N.Y. 10004	50
Hirsch & Co.	25 Broad Street New York, New York 10004	125
JEN Securities, Inc.	26635 Woodward Avenue Huntington Woods, Michigan 48070	30
Kamen & Company	50 Broadway New York, New York 10004	30

Kenower, MacArthur & Co.	Ford Building Detroit, Michigan 48226	30
Kohlmeyer & Co.	147 Carondelet Street New Orleans, Louisiana 70130	125
Manley, Bennett, McDonald & Co.	1100 Buhl Building Detroit, Michigan 48226	30
Mason & Lee, Inc.	Corner 8th & Church Streets Lynchburg, Virginia 24505	30
McKinney, Rose & Company, Inc.	Mercantile Bank Building Dallas, Texas 75201	50
Parker, Bishop & Welsh, Inc.	100 Park Avenue Oklahoma City, Oklahoma 73102	30
Rauscher Pierce & Co., Inc.	1200 Mercantile Dallas Building Dallas, Texas 75201	125
Roberts, Scott & Co., Inc.	First National Bank Building San Diego, California 92101	50
The Robinson-Humphrey Company, Inc.	Two Peachtree Street, N.W. Atlanta, Georgia 30303	125
Rosenthal & Co.	40 Wall Street New York, New York 10005	50
Russ & Company, Inc.	Alamo National Bldg. San Antonio, Texas 78205	30
Sanders, & Company, Inc.	830 Republic National Bank Bldg. Dallas, Texas 75201	50
Schneider, Bernet & Hickman Securities Corporation	3200 First National Bank Building Dallas, Texas 75202	125
Joseph Sebag Incorporated	523 West Sixth Street Los Angeles, California 90014	30
Underwood, Neuhaus & Co. Incorporated	724 Travis Houston, Texas 77002	125
Weber, Hall, Cobb & Caudle, Inc.	1800 LTV Tower Bldg. Dallas, Texas 75201	50
Zuckerman, Smith & Co.	30 Broad Street New York, N.Y. 10004	50
	Total	3,300

EXHIBIT Px-38 - "COMFORT LETTER" DATED 10/30/69 FROM H&M TO LADENBURG

Herman & MacLean
CERTIFIED PUBLIC ACCOUNTANTS
3361 PENOBSCOT BUILDING
DETROIT, MICHIGAN 48226

October 30, 1969

To the Board of Directors of
Texas International Speedway, Inc.
and Ladenburg, Thalmann & Co.

Gentlemen:

This letter is being written pursuant to Section 11(h) of the agreement dated October 30, 1969 between Texas International Speedway, Inc. and Ladenburg, Thalmann & Co., Representative of the several Underwriters, covering the sale of 3,300 units (consisting of a $1,000.00 Debenture and 100 Shares of Common Stock per unit) of Texas International Speedway, Inc.

We have made an examination of the balance sheet of Texas International Speedway, Inc. as of May 31, 1969, the related statement of cash receipts and disbursements, and schedules for the period from date of incorporation on January 13, 1969 to May 31, 1969, and our opinions dated October 27, 1969 with respect to the foregoing are included in the Registration Statement (Number 2-33510) filed by Texas International Speedway, Inc. (the "Company") under the Securities Act of 1933 (the "Act"). Such Registration Statement and related Prospectus, as amended at the time such Registration Statement becomes effective, are herein referred to respectively as the "Registration Statement" and the "Prospectus".

We are independent public accountants as required by the Act and the applicable published rules and regulations of the Securities and Exchange and Commission thereunder.

In our opinion, the financial statements and the related schedules examined by us and included in the Prospectus or elsewhere in the Registration Statement comply as to form in all material respects with the applicable accounting requirements of the Act and of the published rules and regulations relating to financial statements with respect to registration statements on Form S-1 (and Form S-2 where applicable).

As you know, the Company has had no operations to date; therefore the Prospectus did not include a statement of income.

The Agreement provides that we make a limited review, but not an audit of the financial data and accounting records of the Company, for the period subsequent to May 31, 1969, and we made inquiries of responsible officers of the Company and other specific inquiries as to transactions and events subsequent to May 31, 1969, inspected the minutes of the meetings of the shareholders and Board of Directors of the Company during the period from June 1, 1969 to the date of our opinions contained in the Registration Statement and Prospectus. With respect to the meetings of shareholders and the Board of Directors held on September 23, 1969, we relied on the signed notes made by the Assistant Secretary of the Company as to the actions taken at such meetings.

We have not made an examination in accordance with generally accepted auditing standards of any financial statements or the books and records of the Company for the period subsequent to May 31, 1969. Therefore, we are unable to and do not express any opinions on the

unaudited balance sheet as of August 31, 1969, statement of cash receipts and disbursements for the period from date of incorporation on January 13, 1969 to August 31, 1969 all of which appear in the Registration Statement and Prospectus.

Based upon this limited review as outlined above, nothing had come to our attention which in our judgment would indicate that during the period from June 1, 1969 to the date of our opinions contained in the Registration Statement and Prospectus there has been any change in the financial statements and the related schedules not examined by us which are included in the Registration Statement and the Prospectus that do not comply as to form in all material respects with the applicable accounting requirements of the Act and the published rules and regulations relating to financial statements with respect to Registration Statements on Form S-1 (and Form S-2 where applicable) or were not prepared in accordance with generally accepted accounting principles and practices applied on a basis consistent in all material respects with the audited financial statements and the related schedules so included or do not fairly present the information purported to be shown or that any material adjustments are required or that any adjustments other than normal recurring accruals have been reflected therein.

Based upon the limited review described in detail above, nothing had come to our attention which in our judgment would indicate that during the period from June 1, 1969 to the date of our opinions contained in the Registration Statement and Prospectus, there had been any material change in the capitalization of the Company or any material adverse change in the financial position or the results of operations of the Company, except as set forth in the Registration Statement and the Prospectus (in this

regard, we call your attention specifically to Note A to the Financial Statements).

Based upon the limited review made subsequent to May 31, 1969 as described in detail above and the examination referred to in our opinion of independent certified public accountants and consent and opinion of independent certified public accountants included in the Registration Statement and the Prospectus, we have no reason to believe that any adjustments for a fair presentation of the information purported to be in the Registration Statement and the Prospectus is required with respect to the following items:

1) in answer to Item 26 thereof insofar as it relates to dates and number of shares of Registrant's Common Stock.
2) in answer to Item 30 thereof.
3) in answer to Item 31 (a) thereof.

In this regard, it should be noted that the answer to Item 25 in the Registration Statement refers to Item 26 which has been commented upon above. Moreover, we cannot comment on Item 27 since the Registration Statement indicates that this Item is not applicable; and to the best of our knowledge and belief, the Company has no subsidiaries.

Based upon the limited review made subsequent to May 31, 1969 as described in detail above and the examination referred to in our opinion of independent certified public accountants and consent and opinion of independent certified public accountants included in the Registration Statement and the Prospectus, we have no reason to believe that any adjustments for a fair presentation of the dollar amounts, percentages and other figures set forth in Registration Statement and the Prospectus is required

with respect to the following items (hereinafter dollar amounts, percentages and other figures are referred to as "the amount (s)"):

1) in paragraph number 3 in the Introductory Statement, the amounts shown in the third sentence shown thereunder.

2) the amounts contained in Paragraph 7 in the Introductory Statement.

3) subject to the accuracy of the estimated offering expenses of $140,000, all of the amounts shown in the tabulation contained under the Use of Proceeds caption setting forth the proceeds of this offering and the proceeds of previous financing.

4) in the tabulation setting forth the application of the above proceeds under the Use of Proceeds caption, the portion of the estimated cost being financed by the 6% secured promissory notes and the deferral of liability for racing sanction costs aggregating $1,204,723.

5) the amounts contained in the Capitalization caption.

6) all of the amounts contained in the sub-caption "The Company" of caption "History and Business".

7) in the second paragraph under the sub-caption "Sanctions" appearing under the caption "History and Business", the sanction fee for the Canadian-American Challenge Cup Race and the amounts contained in the penultimate sentence in the same paragraph.

8) the indicated prize money for the Canadian-American Challenge Cup Race in 1969 under the sub-caption "Prizes" under the caption "History and Business".

9) the amounts contained in the penultimate paragraph under the sub-caption "Sources of Revenue" under the caption "History and Business".

10) the amounts set forth in the first paragraph under the caption "Plant and Property".

11) the Financial Statements.

The term "financial position" is used in this letter in its conventional accounting sense; accordingly, it relates to the financial statement of the business as a whole and has the same meaning when used in this letter as it has when used in our opinion contained in the Registration Statement and Prospectus.

It should be understood that the aforementioned limited review does not constitute an examination made in accordance with generally accepted auditing standards and would not necessarily reveal material adverse changes in the financial position of the Company.

This letter is solely for the information of the Board of Directors of the Company and the Representative of the Underwriters and it is not to be referred to in whole or in part in the Registration Statement or Prospectus or quoted by excerpt or reference outside the underwriting group in connection with the registration under the Act or the sale of the securities, except for any reference to it in an underwriting agreement or in any list of closing documents.

Very truly yours,

/s/ Herman & MacLean
Certified Public Accountants

EXHIBIT Px-40 – LETTER TO H&M FROM TIS DATED 12/22/69

EXECUTIVES OFFICES:
2990 West Grand Boulevard
Detroit, Michigan 48202

December 22, 1969

Herman & MacLean
3361 Penobscot Building
Detroit, Michigan 48226

Gentlemen:

We hereby release you from any responsibility that you may have to us in connection with the October 30, 1969 letter which you issued to us and to Ladenburg, Thalmann & Company.

Very truly yours,

TEXAS INTERNATIONAL SPEEDWAY, INC.

/s/ Lawrence H. LoPatin
President

LHL:pm

EXHIBIT Px-44 – MEMO FROM WALTER J. PETSCHEK, ESQ. TO LADENBURG, DATED 1/26/70

MEMORANDUM

To: Messrs. JOHN ROSENTHAL
BOB McDONALD
JEFF WEISS
cc: Messrs. PAUL BURAK
GERRY WALPIN

January 26, 1970

Loren Robinson and Ric Herman and I met at the Securities Commission this morning as arranged. Our conversation before we went up to see Carl Bodolus, the Branch Chief on Texas International was general. I told Loren that I expected him and Ric to do the talking and that I would not talk beyond pleasentries unless I disagreed or Bodolus asked me questions.

The meeting with Bodolus didn't take longer than ten minutes.

Loren stated that we were disturbed because expenses had exceeded the estimates by a substantial amount and because "we" (I don't know who is "we") hadn't realized this until mid-week last week and that, if we had known it earlier, we would have stickered the Prospectus, but that we didn't know what we should do now. He then turned it over to Ric.

Ric referred to the "Use of Proceeds" on page 7 of the Prospectus (Bodolus had a copy with the November 12 (not the December 23 sticker on it) and said he would go over the items.

According to Ric (to be checked by Jeff Weiss):

Start with the $6,249,000 total and deduct the last two items; we get to $5,494,000.

Clearing, grading and excavating-over by	$81,000
Paving – over by	136,000
Safety and pit walls, etc. (blamed on NASCAR demands) – over by	106,000
Miscellaneous – over by	370,000
of which $121,000 is seeding not mentioned under Use of Proceeds	
	$493,000

There is approximately $10,000 of overestimates.

Bodolus made notes on his copy of the Prospectus. When Ric got finished, Bodolus said he didn't see anything to be gained from stickering the Prospectus at this point and he didn't know why this couldn't have been cleared by telephone.

Meeting concluded – no question about sanction costs and "other expenses", no question about how excess is to be paid. (Loren did point out that the three fellows sitting at Bodolus' desk had not been paid.)

Bodolus did not know about the STP transaction. I let him ready my copy of the broad tape announcement but there wasn't any discussion.

Loren, Ric and I rode out to the airport together.

I told Loren that I would be in Detroit on Wednesday with Bob. He, talking about the ARI meeting as I later discovered, said he hadn't yet seen a notice of the meeting though it had to be held in connection with the SPC deal. He knew nothing about the Texas meeting.

If I am getting the truth, Loren and Ric have been laying down guide lines for Larry. They haven't thought out the fine points like (a) the propriety of Texas paying its majority stockholder once (not mind twice) when it had substantial other obligations, (b) the fact that, as a result of the repayment of the second one, the contractor had cash receipts exceeding cash outlay by $40,000 (plus or minus) and (c) that Bob's resignation from American's board – of which they were not aware – may have been essential from a conflict point of view.

They have both resigned from everything, Loren on a tentative basis (my guess is that a $25,000 ($15,000?) payment on account of what is due him will hold him) and Ric very definitely. However, they both assured me, I think honestly, that they were sticking with Texas until all worries had been dispelled – I'll be 100 years old fairly soon so I won't be around when that particular millenium comes.

I asked Loren about the payment to NASCAR – he said he had urged Larry to make it but he was certain Larry hadn't done so.

Loren asked how Dave Witts felt but didn't comment when I told him that he agreed completely with Bob that they had to do something about the situation. Actually, Loren agrees of course. I told them that Wednesday's meeting must consider things to do to bridge the period between now and STP consummation (or Chapter XI).

/s/ WALTER J. PETSCHEK

WJP/SGS

EXHIBIT Px-75 – CERTIFICATE SIGNED BY LOPATIN AND SHARE DATED 11/7/69

CERTIFICATE

The undersigned, LAWRENCE H. LoPATIN and LESLIE SHARE certify:

1. That they are respectively the President and Treasurer and the Executive Vice President of TEXAS INTERNATIONAL SPEEDWAY, INC., a Texas corporation, (the "Company").

2. That they have carefully examined the Registration Statement and the Prospectus dated October 30, 1969 of the Company relating to the sale of 330,000 shares of the Common Stock, $1.00 par value, of the Company and $3,300,000 of 8% Participating Subordinated Debentures due October 15, 1984 of the Company, that this certificate is made and delivered pursuant to the provisions of Section 11.(i) of that certain Underwriting Agreement between the Company and Ladenburg, Thalmann & Co. dated October 30, 1969, and:

   (i) As of the effective date of the Registration Statement, the statements made in the Registration Statement and the Prospectus were true and correct, and neither the Registration Statement nor the Prospectus omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.

   (ii) Since the effective date of the Registration

Statement, no event has occurred which is required by the Securities Act of 1933 as amended, or the Rules and Regulations of the Securities and Exchange Commission to be set forth in a supplement to or amended of the Prospectus, but which has not been so set forth.

(iii) Since the respective dated as of which, or periods for which, information is given in the Registration Statement and the Prospectus, there has not been any material adverse change in the condition of the Company, financial or otherwise, or in the earnings of the Company, from that set forth in the Registration Statement and the Prospectus, whether or not arising in the ordinary course of business, other than changes which the Registration Statement and the Prospectus indicate might occur after the effective date of the Registration Statement.

(iv) No stop order suspending the effectiveness of the Registration Statement has been issued and no proceedings for such purpose have been taken or are, to the knowledge of each signer hereof, contemplated by the Securities and Exchange Commission.

(v) (a) Between October 30, 1969 and the date hereof, the Company has not sustained any loss on account of fire, explosion, flood, accident, calamity or any other cause of such character as materially adversely affects its business or properties, whether or not such loss is covered by insurance.

(b) Between October 30, 1969 and the date hereof, except as disclosed in the Registration Statement and the Prospectus, there has been no litigation instituted against the Company involving the reasonable possibility of judgments or liabilities (not insured against) against the Company in any one case in excess of $20,000 or in the aggregate of more than $50,000 and between such dates there has been no proceeding instituted or threatened against the Company before or by any federal or state court, commission, regulatory body or administrative agency or other governmental body, domestic or foreign, wherein an unfavorable ruling, decision or finding would materially adversely affect the business, operations, financial condition or income of the Company.

(c) Except as contemplated in the Underwriting Agreement or as set forth in the Registration Statement and the Prospectus, during the period subsequent to May 31, 1969, and prior to the date hereof (i) the Company has conducted its business substantially in the usual and ordinary course of business, has not incurred any material liabilities or obligations (direct or contingent), or disposed of any of its assets, or entered into any material transaction, and (ii) the Company has not suffered or experienced any substantially adverse change, financial or otherwise. At the date hereof, the capital stock and surplus accounts of the Company are substantially as great as on May 31, 1969, without considering the proceeds from

the sale by the Company of the Debentures and the Common Stock.

(d) The representations, warranties and agreements of the Company contained in the Underwriting Agreement are true and correct at the date hereof, and all agreements contained in the Underwriting Agreement to be performed on the part of the Company, and all conditions contained therein or set forth in the Registration Statement and the Prospectus, to be fulfilled or complied with by the Company at or prior to the date hereof have been duly performed, fulfilled or complied with.

IN WITNESS WHEREOF, the undersigned have executed the within Certificate and affixed the corporate seal this 7th day of November, 1969.

/s/ LAWRENCE H. LoPATIN,
President and Treasurer

/s/ LESLIE SHARE,
Executive Vice President

Opposition

Office-Supreme Court, U.
FILED
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ALEXANDER L. STEVAS
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No. 81-680

IN THE

Supreme Court of the United States

October Term, 1981

HERMAN & MACLEAN,

Petitioner,

v.

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, Jr., individually and as designated Class Representatives,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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December, 1981

THE CASILLAS PRESS, INC.–1717 K Street, N. W.–Washington, D. C.–223-1220

QUESTION PRESENTED FOR REVIEW

Does an implied cause of action for the fraudulent sale of securities exist under section 10(b) of the Securities Exchange Act of 1934 when the purchasers may have express remedies under other provisions of the federal securities laws?

PARTIES BELOW

Petitioner – appellant in the Court below – is Herman & MacLean. The other appellants in the Court below are Lawrence A. Lopatain and Leslie Share. Respondents – appellees in the Court below – are Ralph E. Huddleston, Chester E. Bradley, individually and as class representatives, the class they represent, and David E. Kemp, Thomas F. Plant, Felton E. Waggoner, Jack H. Barrett, and Daryl Lostax.

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No. 81-680

IN THE

Supreme Court of the United States

October Term, 1981

HERMAN & MACLEAN,

Petitioner,

v.

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, Jr., individually and as designated Class Representatives,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

OPINION BELOW

The opinion of the Court of Appeals is reported at 640 F.2d 534 and is set forth in the Appendix to the petition for a writ of certiorari filed by Petitioner. Pet. App. A-1. The opinion of the Court of Appeals denying Respondents' petition for rehearing and for rehearing *en banc* is unreported and is also set forth in the Appendix submitted by Petitioner. Pet. App. B-1. The District Court issued no opinion. The final judgment of the District Court dated October 16, 1979 containing the findings of

the trial court based on a special verdict is unreported and appears in the Appendix submitted by Petitioner. Pet. App. C-1.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1981. A timely petition for rehearing and for rehearing *en banc* was denied on July 13, 1981. This Court has jurisdiction to review the decision of the Court of Appeals for the Fifth Circuit under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

This case involves the following federal statutes and regulations: section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78j(b), Rule 10b-5, promulgated by the Securities and Exchange Commission thereunder, 17 C.F.R. § 240.10b-5. The relevant texts of the foregoing are set forth in the Appendix attached hereto. Resp. App. A-1.

STATEMENT OF THE CASE

Respondents' counterstatement of the case is set forth in their petition for a writ of certiorari, which is separately filed with this Court.

REASONS FOR DENYING THE WRIT

The fundamental assertion of Petitioner – that this Court has left open the question whether an implied cause of action exists under section 10(b) of the Securities Exchange Act of 1934 when an express action may lie under other federal securities provisions – is correct. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733 n.

15 (1975). Nevertheless, the Court has upheld a private right of action under section 10(b) even when express remedies exist. *E.g., SEC v. National Securities, Inc.*, 393 U.S. 453 (1969) (simultaneous remedies under sections 10(b) and 14 of the Securities Exchange Act of 1934).

The courts of appeals that have recently reviewed this issue, including the Court below, have concluded that the existence of other remedies under the federal securities acts does not preclude suit under section 10(b). *E.g., Wachovia Bank and Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342 (D.C. Cir. 1980), *cert. denied*, 101 S.Ct. 3098 (1981); *Ross v. A.H. Robins Co.*, 507 F.2d 545 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980). Citations to decisions of the courts of appeals that have implied private rights of action under federal securities provisions despite the existence of express remedies under other provisions are set forth in the margin.[1] Petitioner does not cite, nor have Respondents been able to uncover, any decision by any court of appeals adopting the contrary rule. Thus, despite the absence of an authoritative decision by this Court, the issue appears settled.

[1]Dann v. Studebaker-Packard Corp., 288 F.2d 201, 208-09 (6th Cir. 1961) (implied private right of action exists under section 14(a) notwithstanding express remedies provided in other sections); Schaefer v. First National Bank of Lincolnwood, 509 F.2d 1287, 1292-93 (7th Cir. 1975), *cert. denied*, 425 U.S. 943 (1976) (private right of action exists under section 10(b) notwithstanding express remedy under section 9(a)(2)); Vanderboon v. Sexton, 422 F.2d 1233, 1239 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970) (private right exists under section 10(b) notwithstanding express cause of action for negligent misrepresentation under other sections); Matheson v. Armbrust, 284 F.2d 670, 675 (9th Cir. 1960), *cert. denied*, 365 U.S. 870 (1961) (buyers have a private remedy under section 10(b) notwithstanding an express remedy under section 11); Gilbert v. Nixon, 429 F.2d 348, 355 (10th Cir. 1970) (implied private right of action under section 10(b), notwithstanding express remedy under section 12(2)).

As this Court observed in *Blue Chip Stamps v. Manor Drug Stores, supra,* "[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." 421 U.S. at 737. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), prohibits the use of any "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Pursuant to the authority granted by section 10(b), the SEC in 1942 promulgated Rule 10b-5, 17 C.F.R. § 240.10b-5, which prohibits the use of "manipulative and deceptive devices." Section 10(b) does not by its terms afford a civil remedy for its violation. However, in 1946 the district court in *Kardon v. National Gypsum Co.,* 69 F. Supp. 512, 513-514 (E.D. Pa.), held that a private cause of action exists under section 10(b) and Rule 10b-5. Twenty-five years later, this Court for the first time confirmed the existence of a private right of action under section 10 and Rule 10b-5. *Superintendent of Insurance v. Bankers Life & Casualty Co.,* 404 U.S. 6, 13 n. 9 (1971).

Whether a private section 10(b), Rule 10b-5 action may be brought for conduct covered by the express liability provisions of the federal securities laws is not a novel issue. Indeed, as early as 1951, the Second Circuit upheld a private Rule 10b-5 suit brought by common stockholders who claimed injury from the misstatements in a registration statement. "We think that when, to conduct actionable under § 11 of the 1933 Act, there is added the ingredient of fraud, then that conduct becomes actionable under § 10(b) of the 1934 Act and the Rule." *Fischman v. Raytheon Manufacturing Co.,* 188 F.2d 783, 786-787 (2d Cir. 1951).

Moreover, although this Court has recently expressly reserved the question whether section 10(b) applies when express remedies are available, *Blue Chip Stamps v. Manor Drug Stores, supra,* 421 U.S. at 752 n.15, the Court has in the past held that the overlap between section 10(b) and other provisions of the federal securities laws is not a reason for excluding the section 10(b) remedy. In *SEC v. National Securities, Inc., supra,* the Court upheld a Rule 10b-5 suit despite the fact that the conduct for which relief was sought was arguably actionable under section 14 of the 1934 Act governing proxy solicitations. "[T]he existence or nonexistence of regulation under § 14 would not affect the scope of § 10(b) and Rule 10b-5. The two sections of the Act apply to different sets of situations. Section 10(b) applies to all proscribed conduct in connection with a purchase or sale of any security; § 14 applies to all proxy solicitations, whether or not in connection with a purchase or sale. *The fact that there may well be some overlap is neither unusual nor unfortunate."* 393 U.S. at 468 (emphasis added).

The Fifth Circuit in this case, the District of Columbia Circuit in *Wachovia Bank and Trust Co. v. National Student Marketing Corp., supra,* and the Second Circuit in *Ross v. A.H. Robins Co., supra,* have all persuasively argued why the presence of express remedies should not defeat the Rule 10b-5 implied cause of action. First, unlike other statutes from which this Court has declined to imply a private remedy on the ground that the courts "are not at liberty to legislate," *Touche Ross & Co. v. Redington,* 442 U.S. 560, 579 (1979) (no private remedy under section 17(a) of the Securities Exchange Act of 1934),[2] section

[2]*See* Kissinger v. Reporters Committee for Freedom of the Press, 445 U.S. 136, 154 (1980) (no private remedy under the Federal Records Act or the Federal Records Disposal Act); Transamerica

10(b), Rule 10b-5 remedies are well established. *E.g.*, *Touche Ross & Co. v. Redington, supra,* 442 U.S. at 577 n.19; *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 196 (1976). Moreover, contrary to the concern expressed, for example, in *Ernst & Ernst v. Hochfelder, supra,* 425 U.S. at 210, allowing a cause of action under section 10(b) when a cause may also expressly lie under other provisions does not "nullify the effectiveness of the carefully drawn procedural restrictions on these express actions." (Footnote omitted.) To be sure, a plaintiff suing under section 11 is subject to limitations and requirements not applicable to section 10(b). But a section 10(b), Rule 10b-5 plaintiff must prove facts – deceit committed with scienter – not necessary for recovery under section 11.[3] *Chiarella v. United States,* 445 U.S. 222, 226, 235 (1980); *Ernst & Ernst v. Hochfelder, supra.*

Mortage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979) (no private cause of action for damages under the Investment Advisers Act of 1940).

[3]Petitioner, like the Court below, *see* Pet. App. A-6, asserts that Respondents had a remedy under section 11 of the Securities Act of 1933. This question is far from clear. Like section 11, Rule 10b-5 prohibits (in subsection (b)) material misstatements and omissions. Unlike subsection 11, however, Rule 10b-5 also prohibits (in subsection (c)) fraudulent acts, practices, or courses of business. As Petitioner, an accounting firm, points out, Petition at 9 n. 9, accountants are liable for material misstatements under section 11(a)(4) only "with respect to the statement . . . report or valuation, which *purports* to have been prepared or certified" by the accountant. (Emphasis added.) The material misstatements complained of by Respondents are not contained in materials "expertized" by Petitioner. Rather, they are found in the use of proceeds section and the pro forma balance sheet contained in the registration statement, both of which were prepared by Petitioner on behalf of the company, but neither of which was "purported" to have been prepared by Petitioner. Pet. App. A-4 n. 2. In short, Petitioner was a participant in, and an aider and abettor of, a deliberate scheme to defraud. Whether section 11 comprehends such conduct or is restricted to misstatements contained in sections of registration statements that are signed – "expertized" – by accountants is an open question.

Second, section 10(b) applies to all misrepresentations, whereas section 11 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 apply only to misstatements included in documents filed with the SEC. As the Court below and the Second Circuit observed, to deny relief under section 10(b), Rule 10b-5 when a remedy under sections 11 or 18 exists would make the availability of the section 10(b) remedy depend upon whether the misrepresentation was filed with the SEC. "If deceitful statements were made both in SEC filings and elsewhere, then the existence of the Section 10(b) cause of action might depend on whether the investor relied on one or the other." *Huddleston v. Herman & MacLean,* Pet. App. A-10. And "holding that plaintiffs must proceed under the terms of § 18 because the statements were filed with the S.E.C. would encourage corporate managers to include their misrepresentations in material filed with the S.E.C., for the sole purpose of insulating themselves from liability under § 10(b) . . . ." *Ross v. A.H. Robins Co., supra,* 607 F.2d at 556.

Finally, as this Court observed in *Blue Chip Stamps v. Manor Drug Stores, supra,* congressional silence on a longstanding judicial interpretation "argues significantly in favor of acceptance" of the rule by the Supreme Court. 421 U.S. at 733. The bellwether decision on this question — *Fischman v. Raytheon Manufacturing Co., supra* — was decided thirty years ago. Since then Congress has amended the securities laws on a number of occasions; it has never reversed *Fischman.* This lends persuasive support for the proposition that *Fischman* was decided correctly.

CONCLUSION

The question presented by Petitioner is one which was first decided thirty years ago; upon which three circuits have recently reached accord; and upon which no conflict appears to exist among the circuits. However, if the Court believes that the issue of overlapping remedies should be put to rest, then this case presents a good vehicle. But in the absence of any lower court dispute, Respondents believe that the Court should deny the writ of certiorari.

Respectfully submitted,

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December, 1981

APPENDIX

SECURITIES EXCHANGE ACT OF 1934

Section 10, 15 U.S.C. § 78j (1976)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

RULE 10b-5

17 C.F.R. § 240.10b-5 Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Petitioner's Brief

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No. 81-680
No. 81-1076

IN THE

Supreme Court of the United States

OCTOBER TERM 1981

(No. 81-680)
HERMAN & MACLEAN,
Petitioner,

v.

RALPH E. HUDDLESTON AND CHESTER E. BRADLEY,
individually and as class representatives,
Respondents.

(No. 81-1076)
RALPH E. HUDDLESTON AND CHESTER E. BRADLEY,
individually and as class representatives,
Petitioners,

v.

HERMAN & MACLEAN, LAWRENCE A. LOPATIN,
AND LESLIE SHARE,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF HERMAN & MacLEAN AS PETITIONER (No. 81-680) AND AS RESPONDENT (No. 81-1076)

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June 16, 1982

QUESTIONS PRESENTED

In No. 81-680:

Does an implied remedy exist under either § 10(b) of the Securities Exchange Act of 1934 or § 17(a) of the Securities Act of 1933 for purchasers of securities who have an express remedy under § 11 of the Securities Act of 1933 by virtue of the fact that the securities purchased were issued pursuant to a registration statement filed as required by § 5 of the Securities Act of 1933?

In No. 81-1076:

Is the clear and convincing standard the appropriate burden of proof in Rule 10b-5 actions?

PARTIES BELOW

Plaintiffs in the District Court and appellees in the Court of Appeals were Ralph E. Huddleston and Chester E. Bradley, Jr., individually and as designated class representatives of a class consisting of purchasers of securities of Texas International Speedway, Inc., during a ninety-day period commencing with the effective date of a registration statement pursuant to which such securities were issued.

Defendants in the District Court and appellants in the Court of Appeals were Lawrence A. LoPatin, Leslie Share, and Herman & MacLean, certified public accountants.

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Since this Court's recognition of an implied private cause of action under § 10(b) and Rule 10b-5 results from an acquiescence in lower court holdings rather than from a reasoned application of the principles generally governing the implication of private remedies, the Court should apply a strict standard in extending that implied cause of action to transactions for which Congress has provided an express remedy.	9
The Securities and Exchange Commission acted outside its delegated authority in promulgating Rule 10b-5 if the courts can construe Rule 10b-5 to apply to conduct for which a remedy is provided by § 11 of the 1933 Act. The structure of the 1934 Act and the legislative history clearly indicate that the behavior toward which § 10(b)	

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was directed is behavior unrelated to the public offering of registered securities. 12

In applying the Cort factors to the question presented in this appeal, the principal considerations are whether the plaintiffs are "of the class for whose especial benefit the statute was enacted" and whether there is any "indication of legislative intent, explicit or implicit . . . to create such a remedy," Touche Ross & Co. v. Redington, 442 U.S. 560, 581 (1979). 18

Neither the language of § 10(b) nor the legislative history of the 1934 Act suggests a Congressional intent to imply a private cause of action for violations of § 10(b). The structure of the bill enacted as the Securities Act of 1934 clearly indicates that Congress did not intend to provide a private remedy which would duplicate the express remedy provided in § 11 of the 1933 Act. 19

The remedy available to those persons against whom fraud has been exercised in a registered securities offering and who are not provided a remedy under § 11 is one expressly relegated to state law by §§ 16 and 18 of the 1933 Act. 27

The doctrine of legislative reenactment, recently given new force by this Court's opinion in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, ___ U.S. ___, 102 S.Ct. 1825 (1982), fails to support the finding of an implied remedy in the present case. 29

Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951) states the principal basis upon which the lower federal courts have supported

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their findings of implied § 10(b) remedies for registered offerings of securities. Fischman was decided on principles which are inconsistent with the development of the law of implied remedies since Cort. No other case authority, including that relied on by the court below, provides a valid basis for the continued finding of an implied remedy for registered offerings of securities. 31

The case for the implication of overlapping implied remedies under § 17(a) is even weaker than that for implied overlapping remedies under § 10(b). Further, since a violation of § 17(a) may be premised on conduct lacking scienter, to imply a § 17 remedy for a registered offering of securities would create a direct conflict between such a remedy and the standards in § 11. 37

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Because § 10(b) provides a remedy only by implication, the remedial details of the implied cause of action must be furnished by the courts. Where it is feasible to do so, the courts should adopt a uniform rule rather than refer to the law of the forum state. The traditional burden of proof in fraud cases is the clear and convincing standard and that standard should be applied in private Rule 10b-5 actions. 44

The higher degree of opprobrium to a defendant which results from a fraud judgment and the necessity of proving scienter by inference justifies the use of the clear and convincing standard in Rule 10b-5 cases. 46

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No. 81-680
No. 81-1076

IN THE

Supreme Court of the United States

OCTOBER TERM 1981

(No. 81-680)

HERMAN & MACLEAN,

Petitioner,

v.

RALPH E. HUDDLESTON AND CHESTER E. BRADLEY, individually and as class representatives,

Respondents.

(No. 81-1076)

RALPH E. HUDDLESTON AND CHESTER E. BRADLEY, individually and as class representatives,

Petitioners,

v.

HERMAN & MACLEAN, LAWRENCE A. LOPATIN, AND LESLIE SHARE,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF HERMAN & MacLEAN AS PETITIONER (No. 81-680) AND AS RESPONDENT (No. 81-1076)

OPINIONS BELOW

The opinion of the court of appeals (Wisdom, Rubin, Sam D. Johnson, J. J.) is reported at 640 F.2d 534 and is reprinted in the appendix to the petition for writ of certiorari in No. 81-680 (Pet. App. A-1). The opinion of the court of appeals issued in connection with the denial of the petition for rehearing and suggestion for rehearing

en banc is reported at 650 F.2d 815 and is reprinted in the appendix to the petition for writ of certiorari in No. 81-680 (Pet. App. B-1). The district court (Taylor, J.) did not issue an opinion, but the final judgment of the district court, as amended, (without the exhibits attached thereto pertaining to the computation of damages) is reprinted in the appendix to the petition for writ of certiorari in 81-680 (Pet. App. C-1).

JURISDICTION

The court of appeals entered judgment on March 9, 1981. Plaintiffs timely filed a petition for rehearing and suggestion for rehearing *en banc*. On July 13, 1981, the petition was denied, with no member of the panel voting to grant the petition and no Judge of Unit A of the Administrative Unit of the Fifth Circuit requesting that the Court be polled on rehearing *en banc*. The petition of Herman & MacLean for a writ of certiorari (No. 81-680) was filed on October 9, 1981, and invoked the jurisdiction of the Court under 28 U.S.C. § 1254(1) (1976). The petition of plaintiffs for a writ of certiorari (No. 81-1076) was filed on December 10, 1981. On April 5, 1982, the Court granted the petition in No. 81-680, granted the petition in No. 81-1076 as to Question 1 presented by that petition, and consolidated the cases for briefing and argument. By agreement among counsel, this brief is filed as the initial brief to present both issues before the Court.

STATUTORY PROVISIONS AND CASE AUTHORITIES

The text of Sections 4, 5, 11, 12, 13, 16, 17, 18, and 24 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. §§ 77d, 77e, 77k, 77l, 77m, 77p, 77q, 77r, and 77x (1976), and Sections 9, 10, 18, 21(e) and 28(a) of the Securities

Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78i, 78j, 78r, 78u(e) and 78bb(a) (1976), are set forth in the statutory appendix to this brief beginning at page SA 1. The text of Section 11 of the 1933 Act as originally enacted is set forth beginning at page SA-19, and the text of Title II of the 1934 Act is set forth beginning at page SA-24.

A collection of state court authorities on the standard of evidence necessary to prove fraud in the state court is contained in the case authorities appendix beginning at page CA-1.

STATEMENT OF THE CASE

Texas International Speedway, Inc. ("T.I.S.") was organized in January, 1969, to build and operate an automobile racetrack in College Station, Texas. (JA-172a) On June 17, 1969, T.I.S. filed a registration statement pursuant to Section 5 of the 1933 Act for the purpose of registering 3,300 units of securities, each unit consisting of a debenture in the principal amount of $1,000 and 100 shares of T.I.S. common stock. After a series of amendments, the registration statement became effective on October 30, 1969. The offering was underwritten on a firm commitment basis by a group of underwriters represented by Landenburg, Thalmann & Co. (JA-158a) The closing of the underwriting occurred on November 7, 1969, when the managing underwriter delivered to T.I.S. the proceeds from the public sale of T.I.S. securities. The Texas track was completed and placed in operation concurrently with the public offering, and races were held on November 9 and on December 7, 1969. (JA-228a-30a)

The operations of T.I.S. were not successful and on November 30, 1970, T.I.S. filed a petition for bankruptcy under Chapter X of the Bankruptcy Act. (Pet. App. A-2) On August 25, 1972, a class action was filed in the Southern District of Texas, Houston Division, on behalf of persons

claiming to represent the purchasers of the securities sold in the public offering. (JA-1a, 17a) Although the plaintiffs were persons for whose special benefit Congress enacted § 11 of the 1933 Act, the plaintiffs did not allege a cause of action under § 11.[1] Instead, the plaintiffs alleged as a federal cause of action an implied remedy under § 17(a) of the 1933 Act, § 10(b) of the 1934 Act and Rule 10b-5 of the Securities and Exchange Commission thereunder, 17 C.F.R. 240.10b-5. (JA-19a) Although there was no discussion below concerning limitations as affecting the availability of a § 11 remedy, the lapse of almost twenty-one months between the filing by T.I.S. of a bankruptcy petition and the filing by the plaintiffs of their lawsuit creates a reasonable inference that the plaintiffs correctly believed in August 1972 that an action under § 11 would be time barred.[2]

The plaintiffs sued almost the entire array of participants in the T.I.S. offering. (JA-17a, 18a) The only exceptions were T.I.S. itself, presumably because the plaintiffs regarded T.I.S. as judgment proof, and the attorneys who represented T.I.S. in the offering. The persons sued included the former directors and principal officers of T.I.S., Ladenburg, Thalmann & Co. and the other members of the underwriting group, the attorneys for the underwriters, the accountants for T.I.S., the firm of consulting engineers which gave an opinion in the T.I.S. prospectus as to the estimated costs of construction of the racetrack, and the principal contractor for construction of the facility. Some

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[1] The district court certified a class limited to those persons who purchased T.I.S. Securities within 90 days from the effective date of the T.I.S. registration statement and to whom § 4(3) of the 1933 Act required that a prospectus be delivered. (JA-70a)

[2] Section 13 of the 1933 Act requires that any action to enforce a liability arising under § 11 be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made in the exercise of due diligence."

of the persons sued were within the class of persons against whom § 11 of the 1933 Act provides a remedy. Others, such as the attorneys for the underwriters and the contractor, were persons against whom § 11 does not provide a remedy.

After a series of settlements removed the underwriters, the attorneys for the underwriters, and the contractor as defendants, the lawsuit was tried to a jury in the summer of 1979. (JA-101a) The trial court submitted special interrogatories to the jury (JA-141a) and, based on the jury's findings, (Cr. Pet. App 1a) entered judgment against two of the former directors and principal officers of T.I.S. and against the accountants, Herman & MacLean. (Pet. App C-1)

THE COURT OF APPEAL'S OPINION

The court of appeals reversed the judgment of the district court and remanded for new trial because of evidentiary errors, the district court's refusal to submit special interrogatories on the issues of reliance and causation, and the district court's method of determining damages. The court of appeals found against the defendants on both of the issues which would have required rendition: the absence of credible evidence to support jury findings of scienter and the absence of an implied remedy under § 10(b) of the 1934 Act or § 17(a) of the 1933 Act. In providing guidelines for retrial, the court below *sua sponte* addressed the standard of evidence issue, holding that the appropriate standard for Rule 10b-5 proceedings is a standard of "clear and convincing" evidence and not the preponderance of the evidence standard on which the lawsuit was presented to the jury.[3]

[3]The scope of the lower court's holding is not entirely clear. The court's discussion of the standard of evidence issue in that portion of the opinion dealing with scienter and the fact that

Question One: Does an implied cause of action under either § 10(b) of the 1934 Act or § 17(a) of the 1933 Act exist for the benefit of the purchasers of securities sold in registered offerings?

SUMMARY OF ARGUMENT

Because the Court has only acquiesced in lower court holdings on the existence of civil liabilities for violations of § 10(b) and the grounds for such holdings are inconsistent with its recent decisions, the Court should not extend the coverage of the implied remedy to transactions for which a comprehensive statutory remedy is available. Purchasers of securities in registered offerings are the special beneficiaries of the express private remedies provided by § 11 of the 1933 Act. The implication of a private remedy under § 10(b) for purchasers of registered securities creates a cause of action which is materially different, both procedurally and substantively, from the cause of action designed by Congress for registered offerings.

Legislative history of the 1934 Act indicates that Congress intended that § 10(b) provide the Securities and Exchange Commission the ability to regulate newly developed devices and contrivances on the order of those devices and contrivances described in §§ 9 and 10(a) of the 1934 Act. There is no legislative history which indicates that Congress intended to grant the Commission the authority to extend the statutory scheme to persons not already covered by the antifraud provision of the federal securities laws, much less that it intended to authorize the Commis-

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the considerations supporting the clear and convincing standard are primarily relevant to scienter indicate that the court below intended to instruct the district court only as to the submission on retrial of the special interrogatory regarding scienter. For briefing purposes, Herman & MacLean will assume this to have been Judge Rubin's intent.

sion to adopt regulations allowing purchasers of registered securities a private remedy different from and in addition to that prescribed in § 11 of the 1933 Act. The structure of the Securities Exchange Act of 1934 emphasizes the improbability of such an intent, since Title II of the 1934 Act consisted principally of a series of amendments to the 1933 Act, including significant amendments to § 11 of the 1933 Act.

Where the Court has previously addressed the issue of *who* may assert a recognized implied remedy, it has emphasized the importance of determining whether the claimant is within the class of persons for whose *especial* benefit the statute was enacted. On this consideration the Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975) denied to a nonpurchaser offeree of registered securities the right to sue under § 10(b) and in *Piper* v. *Chris-Craft Industries*, 430 U.S. 1 (1977) denied to a tender offeror the right to assert a claim for private relief for alleged violations of § 14(e) of the 1934 Act or Rule 10b-6. The structure of § 10(b) and the circumstances of its enactment preclude the possibility that Congress intended to make purchasers of securities in registered offerings the special beneficiaries of § 10(b).

In the absence of legislative intent expressed by the enacting Congress, this Court has applied the doctrine of legislative reenactment where the statute in question has been comprehensively reenacted following a definitive judicial interpretation. Most recently, the Court applied that doctrine to justify the implication of a private cause of action from four sections of the Commodities Futures Trading Commission Act of 1974, *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, ___ U.S. ___, 102 S.Ct. 1825 (1982). There has been, however, no comprehensive reenactment of the 1934 Act which would indicate that Congress has approved of or acquiesced in the implication of a

private cause of action from Rule 10b-5 in those circumstances where an express remedy exists under § 11.

Except for the venerability of *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951), no consideration supports the existence of a remedy for registered offerings beyond that afforded by Congress. That Congress did not choose to provide a remedy against all persons participating in registered offerings, that § 11 limits the basis for asserting liability as to experts participating in registered offerings, that the limitations period applicable to § 11 actions may in certain instances bar a recovery available if recourse to § 10(b) were permitted, and that § 11 limits the damages recoverable are matters for legislative review and not for judicial revision. The Court is not free to alter or augment an express statutory remedy in order to serve its notions as to social policy or to serve a broadly stated objective for the enactment of the securities laws.

The case for the implication of a private cause of action from the provisions of § 17(a) of the 1933 Act is even more difficult to make than that for § 10(b) of the 1934 Act. First, contemporaneous authoritative discussion regarding the implication of private remedies from § 17(a) indicates a clear lack of legislative intent to establish a private remedy. One of the first two interpretative opinions issued by the Federal Trade Commission with respect to the 1933 Act stated that no civil liability exists for violations of § 17(a). One of the authors of the 1934 Act proposed as part of Title II of the 1934 Act an amendment to § 17 of the 1933 Act and submitted in support of the amendment a memorandum stating that no private right of action would accrue for violations of the amended statute.

No line of case authorities comparable to that applicable to § 10(b) supports the implication of a private remedy

from § 17(a). In particular, there is no authority with respect to the overlapping coverage of § 17(a) and § 11 comparable to *Fischman* v. *Raytheon Mfg. Co.*

Finally, the holding of this Court in *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680 (1980), presents a conceptual difficulty in providing a private cause of action under § 17(a) which would overlap the remedy provided by § 11. In *Aaron*, the Court construed subparagraphs (2) and (3) of § 17(a) as not requiring a showing of scienter. As this Court noted in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 210 (1975), the providing of an implied cause of action for registered offerings which does not require a showing of scienter would produce a result which can not be attributed to Congress.

ARGUMENT

Since this Court's recognition of an implied private cause of action under § 10(b) and Rule 10b-5 results from an acquiescence in lower court holdings rather than from a reasoned application of the principles generally governing the implication of private remedies, the Court should apply a strict standard in extending that implied cause of action to transactions for which Congress has provided an express remedy.

This Court's recognition of an implied private cause of action for violation of Rule 10b-5 is more a matter of historical compulsion than the result of reasoned analysis. The first opinion finding an implied cause of action under § 10(b) was in *Kardon v. National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946). Some twenty-five years later this Court first explored the reach of that implied remedy. In *Superintendent of Insurance* v. *Bankers Life and Casualty Company*, 404 U.S. 6, 13 n. 9 (1971), the Court noted that,

"It is now established that a private right of action is implied under § 10(b)." The Court has also acknowledged the implied right of action under Rule 10b-5 in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976); *Santa Fe Industries* v. *Green*, 430 U.S. 462 (1977); and *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680, (1980). On the basis of considerations more or less identical to those applicable to Rule 10b-5, the Court has implied a private cause of action for violations of the proxy rules, *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). The Court has expressly left open the question whether an implied right of action exists for shareholders-offerees as a result of violations of § 14(e) of the 1934 Act, 15 U.S.C. § 78n(e), *Piper* v. *Chris-Craft Industries*, 430 U.S. 1, 42 n. 28 (1977), and the question whether an implied remedy exists under § 17(a) of the 1933 Act, *Blue Chip Stamps*, 421 U.S. at 733, n. 6.

Beginning in 1975 with *Cort* v. *Ash*, 422 U.S. 66 (1975), the Court substantially revised the basis under which courts may infer private remedies from statutory prohibitions. Prior to the decision in *Cort*, Congressional silence or an ambiguity as to its intent provided an insufficient reason to deny a remedy if the person asserting the cause of action was a member of the special class which the statute was enacted to protect. *Texas & Pacific R. Co.* v. *Rigsby*, 241 U.S. 33 (1916). The federal courts recognized in effect a presumption on behalf of such persons for the implication of a private remedy, rebuttable only by a demonstration that Congress intended the opposite. See the discussion of the evolution from *Rigsby* to *Cort* in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, ___ U.S. ___, 102 S.Ct. 1825 (1982). This change in the standards for implying a private remedy creates an uncertainty as to whether the Court would find an implied

right for violations of either the proxy rules or Rule 10b-5 if the issue were presented as a matter of first impression. Thus, in *Touche Ross & Co.* v. *Redington,* 442 U.S. 560, 577-78 n. 19 (1979), the Court stated, "We also have found implicit within § 10(b) of the 1934 Act a private cause of action for damages [citing *Superintendent*]. But we recently have stated that in *Superintendent* this Court simply explicitly acquiesced in the 25-year-old acceptance by the lower federal courts of an implied cause of action under § 10(b). *Cannon* v. *University of Chicago,* 441 U.S. at 690-91, n. 13, 99 S.Ct. at 1954-55, n. 13."

In *Carlson* v. *Green,* 446 U.S. 14, 19 n. 5, 100 S.Ct. 1468, 1482-3 (1980), (Rehnquist, J. dissenting) the validity of *Borak* was drawn sharply into question:

> In light of this Court's recent decision in *Touche Ross & Co.* v. *Redington,* 442 U.S. 560, 99 S.Ct. 2479, 61 L. Ed. 2d 82 (1979), and *Transamerica Mortgage Advisors* v. *Lewis,* 444 U.S. 11, 100 S.Ct. 242, 62 L. Ed. 2d 146 (1979), it is clear that there is nothing left of the rationale of *Borak.* As observed in both those cases, it is obvious that 'When Congress wished to provide a private remedy, it knew how to do so and did so expressly.' [citing authorities] Because the statute at issue in those cases did not expressly provide for such a remedy and there was no clear evidence of such a Congressional intention in their legislative history, the court, unlike in *Borak,* declined to imply a damage remedy from the statute's broad language.

The language of § 10(b) fails to provide any indication that Congress intended to imply a private right of action. Because the legislative history provides no basis from which the courts may discern such an intention and the 1934 Act expressly provides private rights of action in §§ 9, 16, and 18 (in addition to the express remedies provided

in §§ 11 and 12 of the 1933 Act), it is not unlikely that the Court would refuse to infer a private right of action under § 10(b) if the issue were presented as a matter of first impression. Although this issue is not the question presented in this appeal, the dubious basis for the implication of a private cause of action under § 10(b) in the first instance requires a restrictive approach to providing such a remedy in those circumstances where Congress has enacted a comprehensive legislative scheme for the persons seeking to assert the implied remedy.

The Securities and Exchange Commission acted outside its delegated authority in promulgating Rule 10b-5 if the courts can construe Rule 10b-5 to apply to conduct for which a remedy is provided by § 11 of the 1933 Act. The structure of the 1934 Act and the legislative history clearly indicate that the behavior toward which § 10(b) was directed is behavior unrelated to the public offering of registered securities.

The authorities do not indicate that the validity of the Commission's exercise of rule-making authority in the promulgation of Rule 10b-5 has been seriously challenged in this Court. The Court has indicated, however, a concern that a construction of the Rule permitting a violation to be found as a result of merely negligent conduct would be inconsistent with the statutory basis for the adoption of the Rule and would, to that extent at least, raise an issue as to its validity. In *Ernst & Ernst* v. *Hochfelder*, 412 U.S. 185, the Court stated:

> More importantly, Rule 10b-5 was adopted pursuant to authority granted the Commission under § 10(b). The rule-making power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is " 'the power to adopt regulations to carry into effect the will of

> Congress as expressed by the statute.' " [citing authorities] Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b). For the reasons stated above, we think the Commission's original interpretation of Rule 10b-5 [requiring scienter] was compelled by the language and history of § 10(b) and related sections of the Acts.

412 U.S. 212-14

In *Santa Fe Industries* v. *Green,* 430 U.S. 462, 472 (1977), the Court, in considering whether to construe Rule 10b-5 to prohibit conduct which was neither manipulative nor deceptive, again remarked on the requirement that the scope of Rule 10b-5 be limited by the language of the statute and by such indications of Congressional intent as could be drawn from the legislative history. See also *Aaron* v. *Securities and Exchange Commission,* 446 U.S. 680, 691 n. 8.

A fair reading of § 10(b) and the legislative history indicates that Congress did not intend to authorize the Securities and Exchange Commission to prohibit the conduct which the plaintiffs here contend is proscribed by Rule 10b-5. Thomas G. Corcoran, quoted in *Hochfelder,* 425 U.S. 185, at 202-03 (1976), giving testimony to explain the draftsman's intent in § 10(b), stated that its purpose was to permit the Commission to regulate "any *other* cunning devices," that the subsection was a "catch-all clause to prevent manipulative devices," and that the subsection would authorize the Commission "to deal with *new* manipulative devices." (emphasis added)

This testimony is illuminated by other testimony in which Mr. Corcoran describes generally the structure of

H.R. 7852. He testified that the bill had "at bottom five ideas in it, and all 36 pages tie in around the five ideas." Stock Exchange Regulation: Hearings on H.R. 7852 and 8720 Before the House Interstate and Foreign Commerce Committee, 73rd Cong., 2d Sess. 13, 85 (1934).

Mr. Corcoran described the five ideas in the proposed bill as the control of credit, the control of manipulations, the regulation and control of insider trading, the elimination of abuses in market machinery which tend to make the market a place for speculation rather than investment, and the establishment of a commission whose function would be to deal with the problems of administration of the federal securities laws. Sections 8 and 9 of H.R. 7852 [which became sections 9 and 10 of the 1934 Act] constituted that part of the bill dealing with the second "idea," the control of manipulations. As to those sections, Mr. Corcoran testified:

> Then, we go to the next point, and that is control of manipulations. As I will point out later, there are only a very few real battlegrounds in this Act. Manipulation is not one of them. The provisions of this bill, as to manipulations upon stock exchanges, are agreed to practically everywhere. The Dickinson report agrees with them. The Twentieth Century Fund agrees with them. Matched orders, washed sales, pools, options — all of the rest of them are out. So, control of manipulative practices is really not something your committee has to thrash out around this table.

Id.

Also relevant is the testimony of James M. Landis, then a member of the Federal Trade Commission and one of the principal architects of both the 1933 Act and the 1934 Act. Commissioner Landis' testimony on H.R. 7852 before the House Committee on Interstate and Foreign Commerce

reflects his concern that Congress should give sufficient flexibility to the commission organized to administer the federal securities laws. The testimony also indicates Commissioner Landis' concept of the scope of the powers to be delegated to such commission, both in general and in relation to specific provisions of the bill:

> One [objective of the proposed bill] is flexibility of administration. The problem is very complex, very delicate, very technical. Moreover, our knowledge about many of these things is quite inadequate. So, the flexibility and the opportunity to move rapidly to experiment, as the exchange itself experiments, in pushing through a regulation or trying something for a time, to see what its effects are, is imperative in legislation of this type.
>
> • • • •
>
> I think the best way in which I can bring out the way in which this bill meets that objective of flexibility of administration is by trying to give you a picture of what flexibility it contains, what powers it gives to the commission that it intrusts with the administration of the act. I think that if I can go through the thing, not section by section, in any detailed sense, but just taking the various sections to show the kind of administrative powers that are deputed to the administrative authority.

Id. at 20.

> In describing § 9 of the bill, Commissioner Landis stated:
>
> In section 9 some of the most important powers granted to the Commission are set forth, namely, the power over short selling. Instead of dealing with that by arbitrary requirements one way or another, the ques-

> tion was left to the discretion of the Commission. Subsection (b) of the same section places the use of stop-loss orders within the control of the Commission, and section (c) gives the general power to the Commission to prescribe the rules and regulations governing any other manipulative devices.

Id. at 21.

Section 9(c) of H.R. 7852 became, without substantive amendment, § 10(b) of the 1934 Act.

From the structure of the 1934 Act and from the legislative history, it appears that Congress intended §§ 9 and 10, taken together, to accomplish certain specific objectives with regard to manipulative devices.[4] Congress intended to

[4] One of the more curious aspects of the evolution of Rule 10b-5 is the reading of § 10(b) as prohibiting "deception and manipulation" rather than "devices and contrivances." Although the Court has repeatedly held that the language of the statute must take precedence over all other sources for discerning legislative intent, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J. concurring); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976), it has not read § 10(b) as having the meaning most readily suggested by its grammatical structure. The activities prohibited by § 10(b) are "devices and contrivances." Consistent with the statutory pattern under which conduct regulated by § 10 is prohibited only to the extent determined by the Commission to be improper, Congress appended the language "deceptive and misleading" to describe and limit those devices and contrivances which the Commission should prohibit. The courts have exalted the descriptive language of the statute and have reduced to secondary significance the words used to state the subject of Congressional concern, reading § 10(b) as broadly prohibiting deception and as narrowly prohibiting manipulative devices and contrivances. Only the intervention of the Court in *Santa Fe Industries* v. *Green*, 430 U.S. 462 (1977), stopped, or at least provided an obstacle for, the tendency of the lower federal courts to read § 10(b) as also providing a remedy for violations of fiduciary responsibilities in dealings in securities, even when not accomplished through deception.

prohibit altogether certain conduct which was regarded as intrinsically deceptive and manipulative and as having no legitimate financial or social value (§ 9(a)(1), (2), (3), (4) and (5)); to give the Commission express authority to control by regulation other types of transactions on national securities exchanges, such as pegging, fixing or stabilizing of the price of securities, which were believed to be legitimate as long as exercised in a manner prescribed by the Commission (§ 9(a)(6)); to give the Commission the authority to regulate short sales and stop-loss orders, whether or not involving securities traded on a national securities exchange (§10(a)); and to give to the Commission the authority to regulate devices and contrivances of a similar nature developed in the future (§ 10(b)).[5] Congress provided an express private damages remedy for violation of those activities which were either prohibited or subjected to Commission regulation by § 9 of the 1934 Act but not for violation of the regulations which the Commission might adopt pursuant to § 10.

The Commission's purpose in adopting Rule 10b-5 was unrelated to Congress's intent in enacting § 10(b). The Commission in adopting Rule 10b-5 purported to state a global prohibition against fraud accomplished through deception in connection with the purchase or sale of a security. The circumstances of the adoption of Rule 10b-5 have been graphically recounted in *Blue Chip Stamps* v.

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[5] Although this analysis, with its emphasis on *new* manipulative devices and contrivances, has been given scant attention by the federal courts, it is not original. In his scholarly but little heeded article, *Civil Liability under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 N.W.U.L. Rev. 627 (1963), Professor Ruder concludes, after an analysis of the legislative history, that Congress intended § 10(b) to serve as "a catch-all which the Commission could utilize to thwart new and cunning manipulative devices not then known." 57 N.W.U.L. Rev. at 645.

Manor Drug Stores, 421 U.S. 723, 767 (1975) (Blackmun, J. dissenting) and alluded to in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 212 n. 32 (1976). From those descriptions and from the Court's elaborate comparison of Rule 10b-5 and § 17(a) of the 1933 Act in *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680 (1980), it is clear that Rule 10b-5 represents nothing more or less than § 17(a) reworded to apply to sellers as well as to buyers, to omit the effect-oriented language of § 17(a)(2), and to place the "in connection with" clause at the end of Rule 10b-5 rather than in the introductory paragraph.

Rule 10b-5 was not promulgated to regulate "*other* cunning devices" or "to deal with *new* manipulative devices"; it was promulgated to extend the coverage of the antifraud provisions of the federal securities laws to persons whom Congress failed to include within the ambit of the statutory provisions.

Whether or not the language of § 10(b) and its legislative history permit a reading which avoids the invalidation of Rule 10b-5 in its entirety, a construction of the Rule which provides an implied private damages remedy for transactions covered by § 11 of the 1933 Act is so far beyond any reasonable interpretation of legislative intent that it must be rejected.

In applying the Cort factors to the question presented in this appeal, the principal considerations are whether the plaintiffs are "of the class for whose especial benefit the statute was enacted" and whether there is any "indication of legislative intent, explicit or implicit . . . to create such a remedy," Touche Ross & Co. v. Redington, 442 U.S. 560, 581. (1979).

In *Cort* v. *Ash*, 422 U.S. 66 (1975) the Court enunciated a four-factored test for determining whether to imply a private cause of action for damages.

> First, is the plaintiff 'one of the class for whose especial benefit the statute was enacted,' that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

Cort v. *Ash*, 422 U.S. 66, 78 (1975).

In the years since *Cort*, the Court has further refined the *Cort* analysis, recognizing that the first three factors all pertain in one way or another to legislative intent. Where consideration of those factors indicates a clear absence of any legislative intention, the inquiry ends there. *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 576 (1979); *Middlesex Cty. Sewerage Auth.* v. *Nat. Sea Clammers*, 453 U.S. 1 (1981); *Texas Industries, Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630 (1981).

Neither the language of § 10(b) nor the legislative history of the 1934 Act suggests a Congressional intent to imply a private cause of action for violations of § 10(b). The structure of the bill enacted as the Securities Act of 1934 clearly indicates that Congress did not intend to provide a private remedy which would duplicate the express remedy provided in § 11 of the 1933 Act.

The failure of § 10(b) to provide an express remedy and of the legislative history to indicate that Congress considered the implied remedy issue has been frequently noted. See *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 729 (1975) and the authorities cited. In addition, the Com-

mission, in adopting Rule 10b-5, gave no indication that it considered the question of private civil remedies enforceable under that provision. *Id.* at 730.

Notwithstanding the absence of any indication of legislative intent, the federal courts consistently have recognized the existence of an implied right of action. The grounds for the recognition of an implied remedy under § 10(b) enunciated in *Kardon* and its progeny differ from those the Court has used since 1975 to find implied remedies. Nevertheless, the Court has so far continued to acquiesce in the holdings of the lower federal courts.[6]

The structure of the 1934 Act clearly indicates, however, that Congress did not intend to imply a private remedy for registered offerings of securities. Title II of the 1934 Act was denominated "Amendments to Securities Act of 1933." Those amendments included extensive revisions to § 11 of the 1933 Act. Appended as part of the Statutory Appendix are (i) § 11 of the 1933 Act as originally enacted (beginning at SA-19) and (ii) Title II of the 1934 Act, including the amendments to § 11 enacted as part of the 1934 Act (beginning at SA-24). In Title II Congress amended § 11 of the 1933 Act:

> (a) to provide for the issuance of twelve-months earnings reports and to require a showing of reliance as to those persons purchasing after the date of the issuance of such reports;
>
> (b) to change the burden of proof for the establishment of the due diligence defense as to statements

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[6] The Court has expressly refuted the principal ground on which an implied remedy was found to exist in *Kardon:* that the disregard of the command of a statute is a wrongful act and a tort from which a remedy will be implied in the absence of the showing of a legislative intent to withhold such relief. 69 F.Supp. 512, 513-14 (E.D. Pa. 1946). In *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979), the Court characterized this reliance on tort principles as being "entirely misplaced." (442 U.S. at 568)

made in a registration statement purporting to be made on the authority of an expert or purporting to be a statement made by public official or a copy or extract from a public official document, the burden shifting from requiring the defendant to show that he had reasonable ground to believe and did believe that the matters disclosed were true to requiring the defendant to show only that he had no reasonable ground to believe and did not believe that the matter disclosed was untrue;

(c) to change the standard of reasonable investigation from "that required of a person occupying a fiduciary relationship" to "that required of a prudent man in the management of his own property"; and

(d) to change the measure of damages, to provide a loss causation defense to a defendant who can prove that the losses which the plaintiff suffered did not result from any untruth or material omission in that part of the registration statement with respect to which such defendant's liability is being asserted, to limit the liability for each underwriter (except where an underwriter receives a disproportionate compensation for his service) to the total price at which the securities underwritten by such underwriter and distributed to the public were offered to the public, to provide for the assessment of costs (including reasonable attorneys' fees) against any party if the court believes that the suit or defense was without reasonable merit, and to provide to the trial court the discretionary right to require an undertaking for the payment of such costs (including reasonable attorneys' fees).

Congress also amended § 13 of the 1933 Act to make the statute of limitations periods in the 1933 Act conform

to the limitation periods applicable to the express liability provisions stated in §§ 9 and 18 of the 1934 Act.

Implying a remedy under § 10(b) for § 11 violations assumes that Congress, in adopting a catch-all provision against manipulative devices, casually nullified the carefully wrought provisions governing express remedies for § 11 violations.

The courts first considering the overlap between § 10(b) and § 11 had no difficulty in finding § 10(b) inapplicable. *Montague* v. *Electronic Corp. of America*, 76 F.Supp. 933 (S.D.N.Y. 1948), and *Rosenberg* v. *Globe Aircraft Corp.*, 80 F.Supp. 123 (E.D.Pa. 1948). Of particular interest is the *Rosenberg* opinion, written by the author of the opinion in *Kardon* v. *National Gypsum Co.*, 69 F.Supp 512 (E.D.Pa. 1946). In language which remains cogent 34 years after *Rosenberg* was decided, Judge Kirkpatrick refused to find an implied remedy under § 10(b):

> It cannot be supposed that Congress intended to abolish [the express provisions of § 11] when it enacted sec. 10 of the Act of 1934. By any reasonable rule of statutory interpretation, it would require either an express repeal or an implication of repeal so strong as to be inescapable. The two Acts are unquestionably *in pari materia* and must be construed together to make a consistent whole. Looking at them as one statute it is simply not possible that Congress, having prescribed in elaborate detail procedural requirements which must be fulfilled in order to enforce civil liability attaching to carefully defined type of violation, would have casually nullified them all in a later section. Nor can an intention to do so be deduced from the general provisions of sec. 29 of the Act of 1934, 15 U.S.C.A. § 78bb, which is, 'the rights and remedies provided by this chapter shall be in addition to any and all

> other rights and remedies that may exist at law or in equity • • •.' As a matter of fact 'this chapter' does not provide any remedies for the violations of sec. 10(b). Those remedies arise by the general law of torts, which attaches civil liability to the violation of a criminal statute. The point in *Kardon* v. *National Gypsum Co.*, D.C., 69 F.Supp. 512, was not that the Act itself provided a civil remedy, but that there was nothing in it to indicate that Congress intended to withhold from injured parties the right to recover damages which normally attends violations of a criminal statute.

80 F.Supp 123, at 124-25.

This Court in *Blue Chip Stamps* looked carefully at the relationship between § 10(b) and § 11. The issue in that case differs from that here presented in that the claimant in *Blue Chip Stamps* was an offeree but not a purchaser of registered securities and therefore had no right to sue under § 11. The Court observed the comprehensiveness of the legislative scheme presented by § 11 and suggested, as an alternative ground for its holding that a nonpurchaser could not sue under § 10(b), that since the claimant was not a purchaser of securities offered in a registered offering it was a person for whose benefit Congress might have afforded a remedy under § 11 but chose not to. In language which is directed to almost the identical issue here presented, the Court stated:

> On these facts, . . . extension of a Rule 10b-5 cause of action, far from closing an unforeseen loophole, would extend a private right of action for misrepresentations in a 1933 Act prospectus to those whom Congress excluded from the express civil remedies provided in the 1933 Act to cover such a violation. (421 U.S. at 736 n. 8)

The question presented here differs from that addressed in *Blue Chip Stamps* only in that the holding sought by the plaintiffs in this case would (i) imply a cause of action against (rather than on behalf of) persons not included in the statutory scheme and (ii) extend to areas not covered by § 11 the basis on which plaintiffs may assert liability as to certain of those persons subject to liability under § 11. In this case, for example, the plaintiffs sued the attorneys for the underwriters, who, although they participated in the public offering process, are not subject to liability under § 11. Plaintiffs also sued the contractor principally responsible for constructing the automobile speedway built with the proceeds of the public offering, whose only nexus with the offering was the receipt of a portion of the proceeds in payment of construction costs. Further, plaintiffs asserted liability as to Herman & MacLean for alleged misrepresentations or omissions with respect to materials in the prospectus not covered by its opinion and therefore not providing a § 11 basis for liability.

Even in the halcyon days of Rule 10b-5, the Court distinguished those express statutory remedies which were general in nature from those which were "meticulously detailed." In *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970), the Court permitted the recovery of attorneys' fees in an action based on § 14(a) of the 1934 Act. The Court held that "the specific provisions in §§ 9(e) and 18(a) [allowing the assessment of attorneys' fees] should not be read as denying to the courts the power to award counsel fees in suits under other sections of the Act . . . , any more than the express creation by those sections of private liabilities negates the possibility of an implied right of action under § 14(a)." 396 U.S. at 390-91. The Court then distinguished the holding in *Fleischmann Distilling Corp.* v. *Maier Brewing Co.*, 368 U.S. 719 (1967), denying the assessment of attorneys' fees in actions brought

under the Lanham Act, 15 U.S.C. §§ 1051-1127, on the grounds that the Lanham Act, unlike the remedial provisions of the 1934 Act, "meticulously detailed the remedies available to a plaintiff." The Court noted that the "express remedial provisions [of the Lanham Act] were intended 'to mark the boundaries of the power to award monetary relief in cases arising under the Act.'" (396 U.S. at 391-2)

Since *Mills*, this Court has frequently considered the express versus implied remedies issue, repeatedly holding that the existence of an express remedy indicates a Congressional intent to deny implied remedies. In language reminiscent of *Mills*, this Court held in *Northwest Airlines, Inc.* v. *Transport Workers*, 451 U.S. 77, 97 (1981), that:

> The presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement .... The judiciary may not, in the face of such comprehensive legislative schemes, fashion new remedies that might upset carefully considered legislative programs.

See also *Middlesex Cty. Sewerage Authority* v. *Nat. Sea Clammers*, 453 U.S. 1, at 13-15; *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1975) The remedy provided in § 11 of the 1933 Act for purchasers of registered securities is the most detailed and comprehensive remedy found in the federal securities laws. (Pet. at 9-10). It is unreasonable to suppose that Congress intended the comprehensive remedy provided by § 11, amended as it was in 1934, to run parallel with a remedy implied from a provision of the 1934 Act whose purpose merely was to serve as a catch-all for newly developed manipulative devices and contrivances.

A fundamental canon of statutory construction is that a court must strive to give every provision of a statute meaning. "It is our duty 'to give effect, if possible, to every clause and word of a statute,' *Montclair* v. *Ramsdell*, 107 U.S. 147, 152, . . . rather than to emasculate an entire section . . . ." *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955); *Colautti* v. *Franklin*, 439 U.S. 379, 392 (1979). It is also "an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis*, 444 U.S. 11, 19 (1979). "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." *Botany Worsted Mills* v. *United States*, 278 U.S. 282, 289 (1929); *see United States* v. *Madison County Board of Education*, 326 F.2d 237 (5th Cir. 1964), *cert. denied*, 379 U.S. 929 (1964).

In *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979), the Court refused to recognize an implied private right of action under § 17(a) of the 1934 Act, 15 U.S.C. § 78q(a). The Court reasoned that § 17(a) is flanked by provisions of the Act which explicitly grant private rights of action. *Touche Ross & Co.* v. *Redington, supra*, 442 U.S. at 571-72. In particular, § 18(a), 15 U.S.C. § 78r(a), creates a private right of action specifically for purchasers and sellers who rely on financial reports such as those prepared by the accountant defendants in that case. Since plaintiff did not satisfy § 18(a)'s express purchaser-seller requirement and therefore could not proceed under § 18(a), the Court held that he should not be permitted to side-step the requirement and proceed under a less stringent implied right of action.

The Court has refused to nullify restrictions on express rights of action through implication of broader private actions in areas other than securities regulation. In *Brown*

v. *GSA*, 425 U.S. 820 (1976), the Court rejected the argument that a plaintiff unable to satisfy the procedural requirements of Title VII, 42 U.S.C. § 2000e *et seq.* could bring an action under the Civil Rights Act of 1866, 42 U.S.C. § 1981:

> [Title VII], with its rigorous administrative exhaustion requirements and time limitations, would be driven out of currency were immediate access to the courts under other, less demanding statutes permissible.... It would require the suspension of disbelief to ascribe to Congress the design to allow its careful and thorough remedial scheme to be circumvented by artful pleading.

Id., 425 U.S. at 833.

In *Great American Federal Savings & Loan Ass'n* v. *Novotny*, 422 U.S. 366 (1979), another case involving employment discrimination, the Court again refused to permit a plaintiff to ignore the procedural restrictions of an applicable statutory provision by resort to a broader and less rigid provision:

> If a violation of Title VII could be asserted through [42 U.S.C.] § 1985(c), a complainant could avoid most if not all of these detailed and specific provisions of the law.

Id., 442 U.S. at 375-76.

If the plaintiffs are permitted to proceed in the present case under § 10(b) and Rule 10b-5, they will have succeeded in nullifying the carefully crafted provisions of § 11. Such a result cannot be consistent with Congressional intent.

The remedy available to those persons against whom fraud has been exercised in a registered securities offering

and who are not provided a remedy under § 11 is one expressly relegated to state law by §§ 16 and 18 of the 1933 Act.

To the extent that it is necessary to consider whether the cause of action which plaintiffs here seek to assert is one traditionally relegated to state law, the answer is contrary to an effort to find an implied remedy. The cause of action which plaintiffs seek to assert is grounded essentially in common law fraud principles. It is a cause of action for which state blue sky laws traditionally have provided a remedy. Sections 16 and 18 of the 1933 Act, 15 U.S.C. § 77p and r, preserve the remedies which exist at common law[7] or under the blue sky laws and preserve the jurisdiction of the state securities commissions over any security or any person.

The enactment of these provisions in 1933 demonstrates a clear Congressional intent to leave intact those remedies already existing and to permit the state courts and the state securities commissions to deal with fraud claims in registered offering transactions where § 11 does not provide a remedy. Therefore, the treatment of fraud claims falling outside of the coverage of § 11 is not simply "traditionally relegated to state law." By enacting §§ 16 and 18 of the 1933 Act, Congress expressly relegated such claims to the state authorities.[8]

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[7] See *Independence Shares Corp.* v. *Deckert*, 108 F. 2d 51 (3d Cir 1939) rev'd on other grounds 311 U.S. 282 (1940): "Congress by the language employed sought only to make it abundantly clear that it was not pre-empting this field to the federal jurisdiction, thereby prohibiting recovery to defrauded individuals under the laws of the states as that existing prior to the passage of the Securities Act." 108 F. 2d at 54.

[8] In *Trecker v. Scag*, No. 81-1888, slip op. (7th Cir. June 3, 1982), Judge Posner, concurring, stated his disbelief that Congress intended by the enactment of § 10(b) to create federal jurisdiction

The doctrine of legislative reenactment, recently given new force by this Court's opinion in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, ___ U.S. ___, 102 S.Ct. 1825 (1982), fails to support the finding of an implied remedy in the present case.

In *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran, supra,* the Court held that when an implied cause of action under the Commodity Exchange Act, 7 U.S.C. § 1, was clearly a part of the "contemporary legal context" in which Congress undertook a comprehensive reexamination and amendment by enacting the Commodity Futures Trading Commission Act of 1974, the fact that the amendment left intact the provisions under which the federal courts earlier had implied a cause of action is evidence that Congress affirmatively intended to preserve that remedy. The legislative history of the 1974 amendment also gave the Court an indication that Congress intended to preserve a private remedy.

The Court in *Curran* recognized, however, the difference between applying the legislative reenactment doctrine there and applying that doctrine even to the broad issue of implying any Rule 10b-5 private remedy:

> In terms of the number of years and the number of decisions in which an implied cause of action was recognized, the CEA action does not compare favorably with the Rule 10b-5 action. On the other hand,

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for "local disputes between local residents" over the purchase or sale of securities of closely-held corporations. *Id.* at 15. Nevertheless, Judge Posner felt compelled to abide the shifting of a state court responsibility to the federal courts until this Court intercedes, as it did in *Santa Fe Industries v. Green, supra,* to give effect to Congressional intent. If this Court holds, in the face of §§ 16 and 18 of the 1933 Act, that a § 10(b) remedy may be inferred for registered securities offerings, its holding will compound the misallocation of responsibility between the federal and state courts.

> Congress comprehensively reexamined the CEA in 1974 and did not amend the sections under which the cause of action had been implied; no comparable legislative approval or acquiescence exists for the Rule 10b-5 remedy.

___ U.S. ___, 102 S.Ct. 1825, 1845 n. 88.

At least one commentator has characterized the conclusion stated above as "erroneous," Pitt, "Implied Remedies Pendulum May Be Swinging Back," *Legal Times*, May 17, 1982. Mr. Pitt argues that the 1975 amendments to the federal securities laws constituted the most significant review and strengthening of the federal securities laws since their adoption and that the failure of Congress to reject in those amendments the continuing vitality of at least those private rights of action under Rule 10b-5 that duplicate express remedies in the federal securities laws indicates that Congress affirmatively intended to preserve such remedies.

The Court has already rejected a more plausible version of this argument. In *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680 (1980), the Commission argued that Congress was expressly informed that the Commission interpreted § 10(b) as not requiring scienter in injunctive proceedings and nevertheless enacted the Securities Act Amendments of 1975 and the Foreign Corrupt Practices Act of 1977, leaving the administrative interpretation undisturbed. The Court rejected this argument and held that "since the legislative consideration of those statutes was addressed principally to matters other than that at issue here, it is our view that the failure of Congress to overturn the Commission's interpretation falls far short of providing a basis to support a construction of § 10(b) so clearly at odds with its plain meaning and legislative history." (446 U.S. 680, 694 n. 11) The issue of scienter in injunctive pro-

ceedings is considerably more proximate to the matters dealt with in the Securities Act Amendments of 1975 than is the more legalistic issue of the overlap between § 10(b) and § 11.

The doctrine of legislative reenactment creates an obvious problem when the law lacks clear definition. For example, if Congress is assumed to have been familiar in 1975 and 1977 with lower court authorities permitting overlapping remedies, must it not be assumed that Congress also knew of this Court's decision in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (decided January 9, 1974) stating a rationale inconsistent with the implication of such remedies? The same difficulty with the legislative reenactment doctrine arises when considering the issue of an implied remedy under § 17 of the 1933 Act. What is the law respecting § 17 of which Congress supposedly was aware?

In summary, the absence in both 1975 and 1977 of a clearly defined rule of law on the doctrine of overlapping remedies and the lack of any substantial relationship between that issue and the matters under consideration in the Securities Act Amendments of 1975 or the Foreign Corrupt Practice Act of 1977 preclude the application in this case of the doctrine of legislative reenactment.

Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951) states the principal basis upon which the lower federal courts have supported their findings of implied § 10(b) remedies for registered offerings of securities. Fischman was decided on principles which are inconsistent with the development of the law of implied remedies since Cort. No other case authority, including that relied on by the court below, provides a valid basis for the continued finding of an implied remedy for registered offerings of securities.

The history of implied Rule 10b-5 remedies for registered public offerings is essentially the history of *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951). Before *Fischman*, the courts in *Montague* and *Rosenberg, supra*, denied implied private remedies since the finding of an implied remedy under circumstances where § 11 provides an express remedy would impute to Congress an unreasonable and improbable intent. In *Fischman*, the court changed the philosophical tack for approaching the issue. The court dropped from its stated considerations any reference to Congressional intent and held, in effect, that the improvement on the statutory scheme which accrues from the implication of a private remedy justifies the existence of overlapping remedies. As the court below noted (Pet. App. A-7), *Fischman* provides the "classic reconciliation of the apparent overlap of the express civil liability provisions of the 1933 Act and the cause of action implied in Rule 10b-5" in its holding that " 'when, to conduct actionable under § 11 of the 1933 Act, there is added the ingredient of fraud, then that conduct becomes actionable under § 10(b) of the 1934 Act and the Rule . . . ' " 188 F.2d at 786-87.

Although *Fischman* has for more than thirty years provided the rationale upon which the lower federal courts consistently have permitted the assertion of § 10(b) claims for registered public offerings, the *Fischman* opinion, judged either by contemporaneous or by current standards, is seriously flawed. The principal defect in *Fischman* is its assumption that it is within the province of the federal courts to improve upon the statutory scheme. The court characterized as "untenable" the position that defrauded purchasers of unregistered securities affected by an allegedly misleading registration statement would have no redress under the statute.[9] (188 F.2d at 787) Accordingly, the court

[9] The result which the court of appeals in *Fischman* described as "untenable" is the result approved by the Court in *Blue*

felt constrained to construe § 10(b) to provide such a remedy. Since the opinion makes no reference to the discernment of any actual legislative intent, the *Fischman* opinion must be read as furnishing from the whole cloth the basis for the implication of a private remedy. In *Touche Ross* v. *Redington, supra,* the Court emphatically rejected this view of the role the federal courts:

> [W]e are not at liberty to legislate. If there is to be a federal damages remedy under these circumstances, Congress must provide it. '[I]t is not for us to fill any *hiatus* Congress has left in this area.'

442 U.S. at 579

The *Fischman* court predicated its imputation of an implied remedy on its consideration of an hypothetical fact situation under which purchasers of unregistered securities, the price of which was assumed to have been affected by a misleading registration statement covering a different class of securities, would have been denied relief under the federal securities laws.[10] (188 F.2d at 787) The hypothetical illustrates both the defects in the court's analysis in the particular case and the error in its general approach to the

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Chip Stamps, supra, i.e., the denial of an implied § 10(b) remedy to a person who alleges that he suffered a loss because of misrepresentations made in a registered offering prospectus but for whom Congress did not provide a remedy under § 11.

[10] The belief that the hypothetical purchasers would have had no recourse under the federal securities laws seems clearly erroneous. See Pet. p. 11 and III, Loss, *Securities Regulation,* (1961 ed.), p. 1783, n. 335. Whether Judge Frank would have reached a different conclusion if he had adverted to the §§ 12(1) and 12(2) remedies available to his hypothetical purchasers is open to conjecture, but it seems likely that if he had held the overlapping § 10(b) remedy to be unavailable the course of the law on this issue would have been different.

implied remedy problem. First, since the example, as well as the facts presented in *Fischman*, deal with the issue of remedies available to purchasers of unregistered securities, the case at hand did not require the court's conclusions regarding overlapping remedies.[11]

Secondly, the conclusion in *Fischman* that since § 10(b) "does make 'unlawful' the conduct it describes, it creates such a [civil] remedy," 188 F.2d at 787, reflects the precise analysis which the Courts in *Redington* described as "entirely misplaced," 442 U.S. at 568.

Finally, the most remarkable aspect of the *Fischman* decision is its reliance on unsupported and insupportable assumptions. Despite the fact that until *Hochfelder* was decided in 1976 the question whether liability under Rule 10b-5 requires scienter remained unresolved, *Fischman* assumes the requirement of scienter in order to provide a theoretical basis for the existence of overlapping remedies. This assumption became a self-fulfilling prophecy. In *Hochfelder*, the Court assumed, at least *arguendo*, the existence of overlapping remedies in order to support its finding that Rule 10b-5 requires a showing of scienter:

> Such extension [to permit § 10(b) actions premised on negligent wrongdoing] would allow causes of action covered by § 11 . . . to be brought instead under § 10(b) and thereby nullify the effectiveness of the carefully drawn procedural restrictions on these express actions. See, e.g. *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 786-787 (CA 2 1951).

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[11] The court below correctly discerned that *Fischman* did not present a situation where there were overlapping remedies. Nevertheless, the court relied on *Fischman* to dispose of the implied remedy issue in the present case. (Pet. App. A-7)

425 U.S. 185, 210.

Two other assumptions made by Judge Frank in *Fischman* are that an implied cause of action exists under § 17 of the 1933 Act and that such cause of action requires "adequate allegations of fraud." (188 F.2d at 787 n. 2) Courts have been in serious disagreement as to the first of these assumptions. Compare *International Brotherhood of Teamsters* v. *Daniel*, 561 F.2d 1223 (7th Cir. 1977) rev'd on other grounds, 439 U.S. 551 (1979), with *Shull* v. *Dain, Kalman & Quail, Inc.*, 561 F.2d 152 (8th Cir. 1977). This Court expressly reserved consideration of this issue in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 733, n. 6 (1975), as well as in *Daniel*, 439 U.S. at 557 n. 9. The Court in *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680 (1980) refuted the second of the assumptions, at least as to actions brought under subparagraphs (2) and (3) of § 17(a).

Aside from the rationale stated in *Fischman*, the court below advanced two lines of argument based upon case authorities which permit overlapping remedies. The court relied upon language from *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969) that in considering the authority of the Securities and Exchange Commission to obtain injunctive relief from the courts under the aegis of § 21(e) and § 10(b) of the 1934 Act, the fact that the alleged fraud occurs within the context of proxy solicitation does not preclude the Commission from acting. In reaching this result, the Court observed ". . . the fact that there may well be some overlap is neither unusual nor unfortunate." (393 U.S. at 468) The court below quoted this language with emphasis as indicating that the existence of an express remedy under § 11 should not affect the availability of § 10(b) (Pet. App. A-8). The plaintiffs here in their brief in opposition to Herman & MacLean's petition for writ of certiorari also cited the *National Securities* case, arguing as follows:

> Nevertheless, the Court has upheld a *private* right of action under § 10(b) even when express remedies exist. E.g. *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969) (simultaneous remedies under §§ 10(b) and 14 of the Securities Exchange Act of 1934). (emphasis added) (Brief in Opposition to Pet., 3).

Both the court below and the plaintiffs herein overlook the fact that the Commission in *National Securities* acted pursuant to the authority expressly granted in § 21(e) of the 1934 Act. Therefore, there was no implied remedy issue presented. As this Court observed in *National Securities*, the case presented "none of the complications which may arise in determining who, if anyone, may bring *private* actions under § 10(b) and Rule 10b-5." (393 U.S. at 467 n. 9). There was also no "overlap" in *National Securities* because the defendant's proxy solicitation was not governed by § 14(a) of the 1934 Act or the Commission's proxy rules.

Finally, the court below relied upon the argument advanced in *Ross* v. *A. H. Robins Co.*, 607 F.2d 545 (2d Cir. 1979) *cert. den.* 446 U.S. 946 (1980), that to deny the protection of § 10(b) would "encourage corporate managers to include these misrepresentations in material filed with the S.E.C. for the sole purpose of insulating themselves from liability under § 10(b) and restricting the class of potential plaintiffs to the unlikely few who actually viewed and relied on the misleading information." 607 F.2d at 556 (Pet. App. A-10)

The reliance by the court below upon the *Ross* decision is misplaced. The *Ross* opinion reflects a concern that the § 18 reliance requirement not preclude recovery by plaintiffs who are not required by § 10(b) to establish reliance. In the present case, the plaintiffs, had they preserved their § 11 remedy, might have recovered without demonstrating

reliance. The court below held that in order to recover under § 10(b), the plaintiffs must prove their individual reliance upon the misrepresentations allegedly appearing in the T.I.S. prospectus. Therefore, the policy considerations influencing the decision in *Ross* are not relevant to the present case.

A related problem with the lower court's reliance on *Ross* is the court's treatment of 1933 Act prospectuses and filings with the Commission under the 1934 Act as presenting the same issue concerning the accessibility of these materials to litigants. The argument in *Ross* has a limited force in the present case since T.I.S. prospectuses were required to be delivered to each member of the plaintiff class as a condition to the exemption from registration provided by § 4(3) of the 1933 Act to dealers selling the securities.

In any event, the grounds upon which *Ross* was decided are policy grounds the use of which assumes that the courts may consider policy in deciding whether to infer an implied remedy. Nothing in *Cort* v. *Ash* or any of the numerous successors supports this belief. Indeed, the Court has stated that the absence of legislative intent to provide an implied remedy precludes recourse to policy considerations. *See e.g. Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis*, 444 U.S. 11, 100 S. Ct. 242, 249 (1979).

Starting with *Fischman*, the case law on overlapping private remedies in the federal securities law area has developed along lines which are entirely inconsistent with this Court's holdings on implied remedies. The Court should now bring this area of law into harmony with its other decisions and hold that no implied remedy under § 10(b) exists for registered offerings of securities.

The case for the implication of overlapping implied remedies under § 17(a) is even weaker than that for implied

overlapping remedies under § 10(b). Further, since a violation of § 17(a) may be premised on conduct lacking scienter, to imply a § 17 remedy for a registered offering of securities would create a direct conflict between such a remedy and the standards prescribed in § 11.

Although no contemporaneous authoritative discussion provides an answer as to Congress's intent to provide an implied remedy for violations of § 10(b), the same is not true as to § 17(a) of the 1933 Act. On October 30, 1933, Commissioner Landis of the Federal Trade Commission addressed the New York State Society of Certified Public Accountants and dealt with the issue of civil liability under § 17(a) as follows:

> The suggestion has been made on occasion that civil liabilities arise also from a violation of § 17, the first subsection of which makes unlawful the circulation of falsehoods and untruths in connection with the sale of a security in interstate commerce or through the mails. But a reading of this section in the light of the entire Act leaves no doubt but that violations of its provisions give rise only to a liability to be restrained by injunctive action or, if wilfully done, to a liability to be punished criminally. That such a conclusion alone is justifiably to be drawn from its provisions is a matter upon which the commission has already made a pronouncement, the authoritative quality of which I shall occasion to consider later.

The American Accountant, "Liability Sections of Securities Act Authoritatively Discussed," November 1933, p. 332.

Further on, Commissioner Landis discusses Federal Trade Commission activity in interpreting the 1933 Act:

> The United States Government, speaking this time through the agency of the Federal Trade Commission,

> says to an issuer — act in such a fashion and no rights, either criminal or civil, will be created against you. It would, indeed, be unusual if action and reliance upon such advice should be treated by another agency of the same government — the courts — as subjecting the parties so advised to liability. This recognition of the fact of there being something akin to estoppel present in such action by the commission, has naturally made the commission, as distinguished from its divisional officials, chary of the exercise of these powers. *Only two commission opinions have thus far been rendered, and these naturally merely make explicit what is already implicit within the Act.* (Emphasis added)

Id. at 334.

Commissioner Landis' description of the effect of Federal Trade Commission action is supported by the section of the 1934 Act which provides for the transfer of duties from the Federal Trade Commission to the Securities and Exchange Commission:

> Sec. 210. Upon the expiration of sixty days after the date upon which a majority of the members of the Securities and Exchange Commission appointed under Sec. 4 of Title I of this Act have qualified and taken office, all powers, duties, and functions of the Federal Trade Commission under the Securities Act of 1933 shall be transferred to the Commission. . . . All orders, rules, and regulations which have been issued by the Federal Trade Commission under the Securities Act of 1933 and which are in effect shall continue in effect until modified, superseded, revoked, or repealed. All rights and interests accruing or to accrue under the Securities Act of 1933, or any provision of any regulation relating to, or out of any action taken by, the

> Federal Trade Commission under such act, shall be followed in all respects and may be exercised and enforced.

No suggestion is intended that the Court is estopped by a 1933 interpretative opinion of the Federal Trade Commission from inferring a private remedy under § 17(a). It is submitted, however, that the foregoing provides an insight into the "contemporary legal context" in which the 1933 and 1934 Acts were enacted.

Additional guidance is available from the legislative history of the 1934 Act. Senator Fletcher, an author of the 1934 Act, proposed as a part of Title II of the Act an amendment to § 17 of the 1933 Act to deal with abuses arising in connection with the operation of securities holders protective committees. The proposed amendments included an amendment to § 24 of the 1933 Act, 15 U.S.C. § 77x, to extend the penalty provisions of § 24 to persons filing false or misleading reports pursuant to the proposed amendments to § 17. Senator Fletcher entered into the Congressional Record a memorandum explaining his proposed amendment, which stated in part:

> It is to be noted that enforcement of the provisions of the new subsection is left to injunction, stop order, and criminal prosecution. No civil liability attaches for violation thereof.

78 Cong. Rec. 8712 (1934)

Since § 24 was already applicable to persons violating § 17(a), the case for implication of civil liability for violation of § 17(a) is the same as the case for the implication of

civil liability for violation of the subsection which would have been added by Senator Fletcher's amendment.[12]

The implication of a private cause of action from § 17(a) for registered public offerings would run afoul of the theoretical ground which purportedly justifies in the first instance the availability of concurrent remedies. As held by Judge Frank in *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951) and as adverted to by the Court in *Hochfelder*, 425 U.S. 185, 210, the implication of private remedies from a statute which provides for recovery premised on negligent wrongdoing would nullify the carefully drawn procedural restrictions on the express remedies provided by § 11 of the 1933 Act. Since the Court has held in *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680 (1980), that scienter is not required to establish a violation of subparagraphs (2) and (3) of § 17(a), it is clearly not permissible for the courts to infer for registered public offerings an implied civil liability based upon § 17(a). One might, of course, argue that this difficulty could be avoided

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[12] If the intervening lower court authorities are put to one side, the case for the implication of civil liability for violations of Rule 10b-5 is weaker than the case for the implication of civil remedies for violations of § 17(a). It is surely more reasonable to believe that Congress intended an implied remedy for a violation of the statute than to believe that it intended to create an implied remedy in delegating broad rule-making authority to the Commission. In this vein, see Thayer, *Public Wrong and Private Action*, 27 Harv. L. Rev. 317, 320-21 (1913):

> The impropriety of such speculation about an unexpressed legislative purpose to benefit individuals is more clearly apparent with an ordinance than a statute. An inferior body exercising delegated powers must keep strictly within them; and the authority to create new civil rights and duties is not to be inferred from the mere power to enact traffic ordinances and to provide penalties for breaking them.

by requiring that scienter be established under § 17(a) for registered public offerings but not otherwise. The complete response to this suggestion, and a principle which should apply generally to the implication of private remedies, was given by an early commentator of the subject:

> [I]n formulating the principles which are to govern the jury's action [in suits involving implied private remedies], the scholar must vigilantly resist the temptation to spin his own web of theory and distinction, pleasing perhaps in ingenuity and symmetry, but too fine for everyday use.

Thayer, *Public Wrong and Private Action*, 27 Harv. L. Rev. 317, 318 (1913)

The same vigilance should be shown by the courts in resisting the temptation to provide a forum and a remedy for every aggrieved person, even those who have disdained an express remedy because they find an implied remedy more to their liking. The case history of Rule 10b-5 demonstrates beyond question the tangled web of theory and distinction which the lower courts will spin, if left to their own devices, in order to maintain access to the federal courts through implied remedies.

CONCLUSION

The holding of the court below that an implied remedy under § 10(b) or § 17(a) exists for registered offerings of securities should be reversed.

Question Two: Is the clear and convincing standard the appropriate burden of proof in Rule 10b-5 actions?[13]

SUMMARY OF ARGUMENT

In determining the appropriate burden of proof for an implied cause of action, the initial task is to determine the source of controlling law. Three possibilities exist. First, the Court might apply the burden of proof that applies where fraud is an element of a claim arising under federal law in a non-securities case. This burden of proof is the clear and convincing standard. Secondly, the Court might determine and then apply the rule generally prevailing in the state courts for proving the intent element of common law fraud. The standard of evidence prevailing in the state courts is the clear and convincing standard. Finally, the Court could apply the approach used in determining the limitations period applicable to Rule 10b-5 private actions and hold that scienter must be proved according to the standard of evidence applicable to fraud actions under the law of the forum state. The third approach is the least appropriate both because it is inherently imprecise and because it encourages forum shopping.

The court below based its holding on the fact that the clear and convincing standard is the traditional burden of proof in fraud cases and on two additional considerations which have particular application to the present case. It held that since a plaintiff must use inferences to establish fraud, a higher standard of evidence is appropriate. The court also held that the greater damage to a defendant's reputation which results from a fraud judgment justifies the application of a higher standard of

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[13] As noted in footnote 3, *supra*, the following argument assumes that the court below intended to limit its clear and convincing holding to the submission of the scienter issue.

evidence than that applicable generally to civil litigation. Both of these considerations justify the use of the clear and convincing standard in the present case.

ARGUMENT

Because § 10(b) provides a remedy only by implication, the remedial details of the implied cause of action must be furnished by the courts. Where it is feasible to do so, the courts should adopt a uniform rule rather than refer to the law of the forum state. The traditional burden of proof in fraud cases is the clear and convincing standard and that standard should be applied in private Rule 10b-5 actions.

A federal court which undertakes to enforce a remedy implied from a broad statutory prohibition is necessarily confronted with an absence of legislative guidance as to the details of such cause of action. The courts must therefore supply the appropriate substantive and procedural details to achieve what they perceive to have been the intent of Congress. In *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1975), the Court observed that in the absence of legislative guidance concerning the contours of Rule 10b-5 actions, the federal courts should follow the law of limitations of the forum state as in other cases of judicially implied remedies. 425 U.S. at 211 n. 30.

The holding in *Hochfelder* was based in substantial part on *Holmberg* v. *Armbrecht,* 327 U.S. 392, 395 (1945), where the Court held that as to actions at law the silence of Congress has been interpreted to mean that it is federal policy to adopt the local limitation law, observing that this result "is a phase of fashioning remedial details where Congress has not spoken but left matters for judicial determination within the general framework of familiar legal principles."

Holmberg was in turn based upon *Board of Comm'rs* v. *United States*, 308 U.S. 343 (1939), in which the Court denied the United States the right to recover on behalf of an Indian interest on taxes wrongfully collected by a Kansas county taxing authority. The Court held that Kansas law on the right to interest was not irrelevant, as the United States argued, or controlling, as the taxing authority argued. Rather, it held that the right to interest was a remedial detail which Congress intended to leave to judicial interpretation. Acting on the principle that Congress had left the federal courts free to determine the appropriate result by reference to traditional legal principles, the Court elected in the circumstances to respect the state law denying the right to recover interest.[14]

The court below found that the clear and convincing standard should be applied because "[t]he traditional burden of proof imposed in cases involving allegations of civil fraud is the 'clear and convincing' evidence standard." (Pet. App. A-17) The federal common law standard of evidence for proving fraud is the clear and convincing standard. *Southern Development Co.* v. *Silva*, 125 U.S. 247, 250 (1888); *United States* v. *American Bell Telephone Co.*, 167 U.S. 224, 251 (1897); *Norton Co.* v. *Carborundum Co.*, 530 F.2d 435 (1st Cir. 1976).

The prevailing rule in the state courts is that fraud must be established by more than a preponderance of the evidence. The state court decisions fall into five general categories. Twelve states apply the preponderance of the evidence standard in fraud actions. Twenty-six states and the District of Columbia require clear and convincing evi-

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[14] It is instructive to note that the Court also held that in the circumstances it would have been inappropriate for the Court to have applied state law notions of laches or state statutes of limitations. 308 U.S. at 351.

dence. Two states define the standard for fraud actions as a preponderance of the clear and convincing proof. Seven states require a standard of proof which, although not termed that of clear and convincing evidence, is a higher standard than a mere preponderance of the evidence. Three states have a dual standard in which clear and convincing is the test for fraud actions in equity and the preponderance of the evidence standard is used for fraud actions at law. The controlling authorities in each state and in the District of Columbia have been categorized and are set forth in the appendix of state law authorities attached for the convenience of the Court.[15]

The higher degree of opprobrium to a defendant which results from a fraud judgment and the necessity of proving scienter by inference jurstifies the use of the clear and convincing standard in Rule 10b-5 cases.

The court below also based its holding on the considerations that (i) "judgment for the plaintiff detracts from a

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[15] One might suggest that the standard of evidence should be determined by the law of the forum state. Although, as noted in *Hochfelder*, 425 U.S. at 210 n. 29, reference to the law of the forum state is the method used to determine the limitations period for implied § 10(b) actions, this approach should be rejected whenever it is feasible to prescribe a uniform rule. Resort to the law of the forum state has the disadvantage of imprecision of application, as is clear from the variety of formulations of the standard of evidence in the state courts. Further, the process of selecting applicable state law produces differing and unpredictable results as the substantive elements of the federal cause of action evolve. Even in dealing with the limitations issue, the federal courts have vacillated in selecting the applicable limitations period. *See Wood* v. *Combustion Engineering, Inc.*, 643 F.2d 339, 344-45 (5th Cir. 1981), in which the court, because of the *Hochfelder* decision, changed the limitations period applicable to 10b-5 actions in Texas. Using the law of the forum state invites forum shopping, which is the principal detraction of referring to the law of the forum state to determine the limitations period.

defendant's reputation to a far greater degree than in other civil litigation" and (ii) "proof of intent to deceive is often a matter of inference." (Pet. App. A-17 n. 19) The former concept is stated in *Addington* v. *Texas*, 441 U.S. 418, 424 (1979). The particular application of the concept to accountants has been observed in *In Re Commonwealth Oil/Tesoro Pet. Corp Securities Litigation*, 467 F.Supp. 227, 250 (W.D.Tex. 1979) and in *Gilman Brothers, Inc.* v. *Peat, Marwick, Mitchell & Co.*, CCH Fed. Sec. L. Rept. ¶ 96,512 (S.D.N.Y. 1978).[16]

The lower court's belief that the necessity for inferential testimony should require that fraud be established by clear and convincing evidence has implications which transcend the issue in the present case. In *Hochfelder*, the Court left open the question "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." 425 U.S. at 194 n. 12. The lower courts have taken footnote 12 to be an invitation to distort the meaning of scienter to the point that the holding in *Hochfelder* has been virtually emasculated. Although the court below held that a clear and convincing standard should have been applied, it also held that the evidence was sufficient under that standard to permit, but not to compel, a finding that each defendant acted with intent to deceive. The court supported this holding as to Herman & MacLean by reference to testimony as to its negligence, its "involvement" in a section of the prospectus expertised by persons other than Herman & MacLean (JA-170a, 211a), and its refusal to give a comfort letter to underwriters on matters beyond

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[16]The lower court opinions address the issue of the sensitivity of an accountant's reputation in relation to the necessity for specific allegations of fraud under Rule 9(b), Fed.R.Civ. Proc. The same considerations apply, however, to the selection of the applicable standard of evidence.

the professional competence of accountants (Pet. App. A-18).[17]

Short of clarifying the definition of scienter — an undertaking which may be beyond the scope of this appeal — the best hope for preventing further undercutting of *Hochfelder* is to require that Rule 10b-5 fraud be proved by clear and convincing evidence.

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[17] The most egregious digression to date from the *Hochfelder* standard occurred in *Hackbart* v. *Holmes*, CCH Fed.Sec.L.Rept. ¶ 98,639 (10th Cir. 1982) where the court affirmed a Rule 10b-5 liability judgment despite a trial court finding that "[the defendant] did not intend to deceive [the plaintiff]," on the grounds that the defendant "acted recklessly in not making sure [the plaintiff] understood he was not going to participate in the growth of the corporation [because he was purchasing preferred stock and not common stock]." *Id.* at 93,153.

CONCLUSION

The holding of the court below that the clear and convincing standard is the appropriate burden of proof for Rule 10b-5 actions should be confirmed.

Respectfully submitted,

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APPENDIX OF
CASE AUTHORITIES

A. States which apply the preponderance of the evidence standard:

1. *Alaska:*

No more than a preponderance of evidence is necessary to establish fraud. Clear and convincing proof is not required." *Saxton* v *Harris*, 395 P.2d 71, 72 (Alaska 1964) (footnote omitted).

2. *California:*

"The foregoing decisions of this court should have laid to rest the early belief that civil fraud must be proved by more than a preponderance of the evidence." *Liodas* v *Sahadi*, 19 Cal.3d 278, 289, 562 P.2d 316, 322, 137 Cal.Rptr. 635, 641 (1977).

"[F]raud need be proved by a 'preponderance of the evidence' rather than 'clear and convincing evidence.'" *Rosener* v *Sears Roebuck and Co.*, 110 Cal.App.3d 740, 756, 168 Cal.Rptr. 237, 246 (1980) appeal dismissed, 450 U.S. 1051 (1981) (restating Liodas v Sahadi, 19 Cal.3d 278, 562 P.2d 316, 137 Cal.Rptr. 635 (1977)).

3. *Delaware:*

"In order to support an action of this kind [fraud], it is necessary for the plaintiff to satisfy the jury by a preponderance of the evidence [the elements of fraud] . . . ." *Nye Odorless Incinerator Corp.* v *Felton*, 35 Del. 236, 252, 162 A. 504, 510 (1931).

4. *Florida:*

"We hold that only a preponderance or greater weight of the evidence is required to establish fraud, whether the action is at law or in equity." *Rigot* v *Bucci*, 245 So.2d 51, 53 (Fla. 1971).

"The burden of proving fraud and deceit is by the greater weight of the evidence." *Blaeser Development Corp.* v *First Federal Savings and Loan Association*, 375 So.2d 1118, 1119 (Fla. App. 1979).

5. *Georgia:*

"Plaintiff-appellant's cause of action is based on fraud, and while fraud may not be presumed, being in itself subtle, slight circumstances may be sufficient to carry conviction of its existence." *Ringer* v *Lockhart*, 240 Ga. 82, 83, 239 S.E.2d 349, 351 (1977).

" 'Fraud may not be presumed, but, being in itself subtle, slight circumstances may be sufficient to carry conviction of its existence.' " *Marriott Corp.* v. *American Academy of Psychotherapists, Inc.*, 157 Ga.App. 497, 277 S.E.2d 785, 787-88 (1981) (quoting Ga.Code Ann. § 37-706 (1979)).

6. *Indiana:*

"Notwithstanding the lack of an exact legal definition, the elements of a cause of action in fraud are well established: To sustain an action for fraud it must be proven by a prepondence of the evidence that a material representation of a past or existing fact was made which was untrue and known to be untrue by the party making it, or else recklessly made, and that another party did in fact rely on the representation and was induced thereby to act to his detriment." *Plymale* v *Upright*, ___ Ind.App. ___, 419 N.E.2d 756, 760 (1981).

"When fraud is relied on as a basis for recovery, the alleging party must prove all of the essential elements of fraud by a prepondence of the evidence." *Grissom* v *Moran*, 154 Ind.App. 419, 290 N.E.2d 119, 123 (1972).

7. *Massachusetts:*

"[T]he rule of evidence was the same in this [fraud action] as in other civil cases;... fraud was not to be presumed, but fairly found by them [the jury] on the evidence; . . . the burden was on the plaintiff to prove his case by the fair preponderance of the testimony." *Kline* v *Baker,* 106 Mass. 61, 64 (1870).

8. *Montana:*

"Fraud can never be presumed but must be proved by a preponderance of the evidence." *Poulsen* v *Treasure State Industries, Inc.,* ___Mont. ___, 626 P.2d 822, 825 (1981).

9. *North Carolina:*

"It is not sufficient merely to charge fraud. Vituperative epithets do not prove it, but the party who alleges any corruption in the making or execution of a contract must establish his allegation by evidence, not beyond a reasonable doubt, nor even by clear and convincing proof, but by a preponderance of the testimony and to the satisfaction of the jury." *Dare County* v *Smith Construction Co.,* 152 N.C. 23, 27, 67 S.E. 37, 38 (1910).

10. *Rhode Island:*

"As Cambrola correctly argues, however, fraud in a civil suit need only be proven by a fair preponderance of the evidence." *Cambrola* v *Kaiser Aluminum & Chemical Corp.,* ___R.I. ___, 416 A.2d 694, 697 (1980).

11. *South Dakota:*

"For the sake of clarity and stability, we now affirm adherence [in a fraud action] to the preponderance of the evidence rather than the clear and convincing standard and *O'Connor* v *O'Connor, supra* [307 N.W.2d 132 (S.D. 1981)]

is hereby modified to the extent it states otherwise." *Jennings* v *Jennings*, 309 N.W.2d 809, 812 (S.D. 1981).

12. *Texas:*

"In order for appellee to have proved a cause of action based upon fraud against the resident defendant, Hargrove, appellee had to prove by a preponderance of the evidence that appellee suffered actual damage as a result of relying upon the false representations of Hargrove." *Wise* v *Thompson*, 540 S.W.2d 837, 839 (Tex.Civ.App. — Texarkana 1976, no writ).

B. States which apply the clear and convincing standard:

1. *Arizona:*

"It is true that actions based on fraud must be proven by "clear and convincing evidence...." *General Accident Fire & Life Assurance Corp.* v. *Little*, 103 Ariz. 435, 443 P.2d 690, 698 (1968).

"Fraud will not be presumed and must be proved by clear and convincing evidence." *Universal Investment Co.* v. *Sahara Motor Inn, Inc.*, 127 Ariz. 213, 619 P.2d 485, 486 (Ariz. App. 1980).

2. *Colorado:*

"Moreover, it [the trial court] found that the Ficor group had failed to carry its burden of proving by clear and convincing evidence the misrepresentation, nondisclosure, and fraud necessary to support its counterclaim. *See Wiley* v. *Byrd*, 158 Colo. 479, 408 P.2d 72 (1965); *Wallick* v. *Eaton*, 110 Colo. 358, 134 P.2d 727 (1943)" *Ficor, Inc.* v. *McHugh*, ___ Colo. ___, 639 P.2d 385, 396 (1982).

"Many decisions of this court point up that fraud must be pleaded with considerable particularity and upon trial

proof thereof must be quite clear and convincing." *Wiley* v. *Byrd*, 158 Colo. 479, 408 P.2d 72, 74 (1965). *But see Goodfellow* v *Kattnig*, 533 P.2d 58, 60 (1975) ("Section 13-25-127, C.R.S. 1973 (1971 Perm. Supp., C.R.S. 1963, 52-1-28) provides for a single burden of proof in all civil actions, that of proof by a preponderance of the evidence, and thus, the court's statement was incorrect.")

3. *Connecticut:*

"Fraud is not to be presumed but must be proven by clear and satisfactory evidence." *Miller* v *Appleby*, — Conn. —, 438 A.2d 811, 813 (1981).

" 'Fraud, of course, is not to be presumed and must be strictly proven by clear, precise, and unequivocal evidence.' " *DeLuca* v. *C. W. Blakeslee & Sons, Inc.*, 174 Conn. 535, 391 A.2d 170, 176 (1978) (quoting Busker v. United Illuminating Co., 156 Conn. 456, 458, 242 A.2d 708, 709 (1968)).

4. *Hawaii:*

"And fraud is never presumed, but must be proved by clear and convincing evidence." *Dobison* v. *Bank of Hawaii*, 60 Hawaii 225, 587 P.2d 1234, 1235 n. 1 (1978).

5. *Idaho:*

"The party alleging the fraudulent misrepresentation has the burden of proving all these elements [of actionable fraud] by clear and convincing evidence." *Faw* v. *Greenwood*, 101 Idaho 387, 613 P.2d 1338, 1340 (1980).

"A party alleging fraud has the burden of proof and all elements of such allegation must be established by clear and convincing evidence." *Smith* v *King*, 100 Idaho 331, 597 P.2d 217, 220 (1979).

6. *Illinois:*

"Similarly, actual fraud is never presumed but must be proved by clear and convincing evidence." *Ray* v. *Winter*, 67 Ill.2d 296, 367 N.E.2d 678, 682 (1977).

"Fraud is never presumed, but must be proved by clear and convincing evidence." *Ronan* v *Rittmueller*, ____ Ill. App. _____, 434 N.F.2d 38, 42 (1982).

7. *Kansas:*

"'We have held fraud is never presumed and must be proven by clear and convincing evidence.'" *Weigand* v *Union National Bank of Wichita*, 227 Kan. 747, 610 P.2d 572, 577 (1980) (quoting Nordstrom v. Miller, 227 Kan. 59, 65, 605 P.2d 545, 552 (1980)). *But see Modern Air Conditioning, Inc.* v *Cinderella Homes, Inc.*, 226 Kan. 70, 596 P.2d 816, 824 (1979) ("The burden of proving fraud is by a preponderance of the evidence, but that evidence must be clear, convincing, and satisfactory."); *Chute* v *Old American Insurance Co.*, 6 Kan. App. 2d 412, 629 P.2d 734, 742 (1981). ("Even though it must be proved by a preponderance of the evidence which must be clear and convincing, fraud, like any other fact, may be proved by showing circumstances from which the inference of fraud is natural and irresistible. . . ")

8. *Kentucky:*

"Our rule is that '[t]he burden is on the party asserting fraud to establish it by clear and convincing proof.'" *Sanford Construction Co.* v *S & H Contractors, Inc.*, 443 S.W.2d 227, 235 (Ky. 1969) (quoting O'Brien v Marvin, 387 S.W.2d 282 (Ky. 1965)).

"The burden is on the party asserting fraud to establish it by clear and convincing evidence." *Wahba* v *Don Corlett Motors, Inc.*, 573 S.W.2d 357, 359, (Ky. App. 1978).

9. *Louisiana:*

"It is well settled that one who alleges fraud has the burden of establishing it by legal and convincing evidence since fraud is never presumed, and that to establish fraud exceptionally strong proof must be adduced." *Hall* v *Arkansas-Louisiana Gas Co.*, 368 So.2d 984, 993 (1979), *modified* 101 S.Ct. 2925 (1981).

"The party alleging fraud has the burden of proving it by legal and convincing evidence . . . . Proof of fraud must be by evidence well beyond a preponderance; exceptionally strong proof is required." *Mitchell* v *Bertolla*, 397 So.2d 56, 58 (La. App. 1981).

10. *Maryland:*

"When fraud, dishonesty or criminal conduct is imputed, something more than a mere preponderance of evidence must be produced; the proof must by 'clear and satisfactory' and be of such a character as to appeal strongly to the conscience of the court." *First National Bank of Southern Maryland* v *United States Fidelity & Guarantee Co.*, 275 Md. 400, 411, 340 A.2d 275, 283 (1975).

"It [Maryland] has established that in such cases [where fraud and deceit are at issue] the burden is on the plaintiff to prove his case by clear and convincing evidence." *Aeropesca Limited* v *Butler Aviation International, Inc.*, 44 Md. App. 610, 411 A.2d 1055, 1063 (1980) (footnote omitted).

11. *Michigan:*

"Fraud will not be presumed but must be proven by clear, satisfactory and convincing evidence." *Hi-Way Motor Co.* v *International Harvester Co.*, 398 Mich. 330, 336, 247 N.W.2d 813, 816 (1976).

"Fraud will not be presumed but must be proved by clear, satisfactory and convincing evidence." *Higgins* v *Lawrence,* 107 Mich. App. 178, 309 N.W.2d 194, 197 (1981).

12. *Minnesota:*

"Fraud must be proved by clear and convincing evidence, especially where a party seeks to avoid the effects of a written instrument." *Weise* v *Red Owl Stores, Inc.,* 286 Minn. 199, 175 N.W.2d 184, 187 (1970). *But see Klapmeier* v *Peat, Marwick, Mitchell & Co.,* 363 F.Supp. 1212, 1219 n.11 (D.Minn. 1973) (dictum stating that in Minnesota fraud can be shown by a preponderance of the evidence.)

13. *Mississippi:*

"Our decision must adhere to the rule requiring establishment of fraud by clear and convincing proof." *Gulf National Bank* v *Wallace,* 394 So.2d 864, 865 (Miss. 1980).

"However, at the trial on remand, complainants have the heavy burden of establishing the allegation of fraud by clear and convincing evidence." *Mosby* v *Gandy,* 375 So.2d 1024, 1028 (Miss. 1979).

14. *Nevada:*

"Here the burden was upon the respondents as the plaintiffs in the action to support their contention of fraud by clear and convincing proof." *Lubbe* v *Barba,* 91 Nev. 596, 540 P.2d 115, 117 (1975).

"Of course, it was the plaintiffs' burden to support their contention of fraud by clear and convincing proof." *Carson Meadows Incorporated* v *Pease,* 91 Nev. 187, 533 P.2d 458, 461 (1975).

15. *New Hampshire:*

"We agree that fraud will never be presumed, but must be established by clear and convincing proof, and that fraud will not be implied from doubtful circumstances." *Burroughs* v *Wynn,* 117 N.H. 123, 370 A.2d 642, 643 (1977).

"Fraud must be established by clear and convincing proof, not 'implied from doubtful circumstances which merely awaken suspicion.'" *Brochu* v *Ortho Pharmaceutical Corp.*, 642 F.2d 652, 662 (1st Cir. 1981) (quoting Lampesis v Conolli, 101 N.H. 279, 283, 140 A.2d 561, 564 (1958)).

16. *New Mexico:*

"Fraud must be proven by clear and convincing evidence." *Rael* v *Cisneros,* 82 N.M. 705, 707, 487 P.2d 133, 135 (1971).

"Fraud must be established by clear and convincing evidence, *Snell* v *Cornehl,* 81 N.M. 248, 466 P.2d 94 (1970), but it is for the fact finder, not the appellate court, to weigh the evidence." *Rodriquez* v *Horton,* 95 N.M. 361, 622 P.2d 261, 264 (N.M. App. 1980).

"Fraud must be proven by clear and convincing evidence because it is an easily made charge that stains the person accused with a mark of dishonesty." *Treider* v *Doherty and Company,* 86 N.M. 735, 527 P.2d 498, 500 (N.M. App.) (a state securities fraud case) *cert. denied* 86 N.M. 730, 527 P.2d 493 (1974).

17. *New York:*

"We observe that, as in the instance of fraud claims generally, this plaintiff, too, will be required to prove her claim by clear and convincing evidence (citations omitted)." *Simcuski* v *Saeli,* 44 N.Y.2d 442, 452, 377 N.E.2d 713, 718, 406 N.Y.S.2d 259, 265 (1978).

"While there has previously been some conflict as to the standard of proof applicable in a fraud action (citation omitted), it now appears that claims of fraud must be established by clear and convincing evidence (*Simcuski* v *Saeli*, 44 N.Y.2d 442, 377 N.E.2d 713, 406 N.Y.S.2d 259)." *Stephenson* v *Lord*, 72 A.D.2d 857, 421 N.Y.S.2d 730, 731 (N.Y.App.Div. 1979).

18. *North Dakota:*

"Fraud must be proved by evidence that is clear, satisfactory, and convincing." *Jones* v *Jones*, 310 N.W.2d 753, 757 (N.D. 1981).

19. *Oregon:*

"The proof in a fraud action must be by clear and convincing evidence." *Bausch* v *Myers*, 273 Or. 376, 379, 541 P.2d 817, 819 (1975).

"We have reviewed the testimony and the exhibits and conclude that the trial court could properly find from the conflicting testimony that plaintiff failed to establish all of the elements of common law fraud, as alleged in the first count of the complaint, with the necessary clear and convincing evidence." *Day* v *Saunders*, 270 Or. 132, 528 P.2d 513, 514 (1974) (a state securities fraud case).

"Fraud can only be established by clear and convincing proof of the perpetration of an intentional wrong by the respondent or the breach of a duty growing out of a fiduciary relationship." *Harder* v *Harder*, 49 Or. App. 582, 619 P.2d 1367, 1370 (1980).

20. *Pennsylvania:*

"Moreover, fraud or intent to defraud is never presumed, and must be proved by 'evidence that is clear, precise and

convincing.'" *Snell* v *Commonwealth State Examining Board,* 490 Pa. 227, 416 A.2d 468, 470 (1980) (quoting Carlson v Sherwood, 416 Pa. 286, 287, 206 A.2d 19, 20 (1965).

"A party alleging fraud has the burden of proving the same by clear and convincing evidence." *Estate of Bosico,* 448 Pa. 274, 412 A.2d 505, 506 (1980).

21. *South Carolina:*

"In order to recover in an action for fraud and deceit, based upon misrepresentation, the following elements must be shown by clear, cogent and convincing evidence . . . ." *M.B. Kahn Construction Co.* v *South Carolina National Bank of Charleston,* ___ S.C. ___, 271 S.E.2d 414, 415 (1980).

22. *Utah:*

"Recognizing that under our accepted rule a finding of fraud must be by clear and convincing evidence, and whether that burden is met is primarily for the trial court to determine . . . ." *Utah State Department of Social Services* v *Pierren,* 619 P.2d 1380, 1381-82 (Utah 1980) (footnotes omitted).

23. *Vermont:*

"The suit . . . was for fraudulent concealment and misrepresentation. This ground requires that the plaintiffs produce evidence meeting the standard of proof of clear and convincing evidence." *Hughes* v *Holt,* ___ Vt. ___, 435 A.2d 687, 689 (1981).

"The parties do not question the applicable rule with respect to plaintiff's burden of proof, i.e., that fraud must

be shown by clear and convincing evidence." *Lincoln* v *Emerson*, 137 Vt. 301, 404 A.2d 508, 510 (1979).

24. *Virginia:*

"We hold that neither party has proved fraud by clear, cogent, and convincing evidence, *see Wolford* v *Williams*, 195 Va. 489, 498, 78 S.E.2d 660, 665 (1953), and damages for fraud will not be in issue on remand." *Erlich* v *Hendrick Construction Co.*, 217 Va. 108, 225 S.E.2d 665, 670 (1976).

"Clear, cogent, and convincing evidence must be presented to prove a claim of fraud under Virginia law." *Crown Central Petroleum Corp* v *Brice*, 427 F.Supp 638, 641 (E.D.Va. 1977).

25. *Washington:*

"The standard of proof in civil fraud cases, including the proceedings instituted by respondent in this case pursuant to RCW 74.04.300, is 'clear, cogent, and convincing evidence.'" *Beckett* v *Department of Social and Health Services*, 87 Wash.2d 184, 550 P.2d 529, 531 (1976).

"In Washington, common law fraud has 9 essential elements, all of which must be established by clear, cogent, and convincing evidence . . . ." *North Pacific Plywood, Inc.* v *Access Road Builders, Inc.*, 29 Wash. App. 228, 628 P.2d 482, 485 (1981).

26. *Wisconsin:*

"Finally, it should be added that for the defendant to successfully defend on the ground of duress all the essential elements must be proved by clear and convincing evidence — the same burden that is imposed upon the plaintiff in asserting his cause of action for fraud." *Wurty* v *Fleischman*, 97 Wisc. 2d 100, 293 N.W.2d 155, 160 (1980).

"[F]raud must be proved by clear and convincing evidence." *Miles* v *Mackle Brothers, Division Deltona Corp.*, 73 Wisc. 2d 84, 242 N.W.2d 247, 250-51 (1976).

27. *District of Columbia:*

"Fraud is never presumed and must be particularly pleaded. It must be established by clear and convincing evidence, which is not equally consistent with either honesty or deceit." *Bennett* v *Kiggins*, 377 A.2d 57, 59 (D.C. 1977).

C. States which apply a preponderance of the clear and convincing proof standard:

1. *Iowa:*

"In any event, since the court of appeals opinion, we have twice confirmed that the 'preponderance of clear, convincing and satisfactory evidence' standard is the appropriate one in damage actions for fraud." *Omaha Bank for Cooperatives* v *Siouxland Cattle Cooperative*, 305 N.W.2d 458, 464 (Iowa 1981).

"Although we have at times used such language [a preponderance of competant evidence] in describing the fraud standard of proof . . . it is clear that the proper burden would require a clear and convincing preponderance of the evidence. . . . A greater showing than a mere preponderance is mandated by the presumption of fair dealing accompanying a transaction (citations omitted) . . . ." *Mills County State Bank* v *Fisher*, 282 N.W.2d 712, 715 (Iowa 1979).

2. *Maine:*

"Evidence is *'clear and convincing'* if by its nature it has high capability of inducing belief . . . . We think it is the considered policy of the law that a litigant who asserts

fraud will be held to fail to meet his burden of proof by a preponderance of the evidence unless he produces evidence having strong capacity to induce belief . . . . In other words, the jury should be told that because of the nature of the issue, i.e. fraud, evidence will constitute preponderance only if it is clear evidence, convincing evidence and unequivocal evidence." *Horner* v *Flynn*, 334 A.2d 194, 199-200 (Me. 1975) (emphasis in original).

D. States which require a standard of proof higher than a preponderance but one not termed "clear and convincing":

1. *Alabama:*

"Fraud, which is never presumed, must be clearly and satisfactorily proven." *Lamb* v *Opelika Production Credit Association*, 367 So.2d 957, 960 (Ala. 1979).

"The general rule is that fraud, when alleged, must be clearly and satisfactorily proven." *Taylor* v *Godsey*, 357 So.2d 979, 980 (Ala. 1978). *See also First Virginia Bankshares* v *Benson*, 559 F.2d 1307, 1320 (5th Cir. 1977), a securities fraud case. ("On the state of Alabama law, we hold that the burden of proof is indeed a preponderance of the evidence. The 'clear and convincing evidence' standard controls the quality or character of the evidence on which the jury may find fraud. We agree, of course, that the imposition of the 'clear and convincing evidence' requirement makes the plaintiff's task more difficult than unadorned proof by a preponderance of the evidence.")

2. *Missouri:*

" 'Fraud of course is never to be presumed; and before evidence may be taken as reasonably supporting an inference of fraud, it must rise above mere suspicion and point logically and convincingly to that conclusion.' " *Cantrell* v

Superior Loan Corp., 603 S.W.2d 627, 634 (Mo.App. 1980) (quoting Hunter v Roberts, 267 S.W.2d 368, 372 (Mo. App. 1954)).

3. *Nebraska:*

"Fraud is never presumed but must be established by the party alleging it by clear and satisfactory evidence." *Erftmier* v *Eickhoff*, ___ Neb. ___, 316 N.W.2d 754, 757 (1982); *Page* v *Andreasen*, 200 Neb. 641, 644, 264 N.W.2d 682, 685 (1978). *See also, La Puzza* v *Prom Town House Motor Inn, Inc.*, 191 Neb. 687, 217 N.W.2d 472, 476 (1974) ("Fraud is never presumed but must be proved by clear and convincing evidence.")

4. *Oklahoma:*

"The burden of proof as to allegations of fraud is upon the party alleging it, and it must be established by clear, unequivocal and competent evidence." *Barriner* v *Stedman*, 580 P.2d 514, 516 (Okla. 1978).

5. *Tennessee:*

"Where fraud is to be shown by circumstantial evidence, such evidence should be considered in its entirety without giving undue importance to isolated facts; although each circumstance alone may be trivial and unconvincing, the combination of all the circumstances considered together may furnish irrefragable and convincing proof of fraud. However, the facts and circumstances proved must clearly establish the inference of fraud." *Jones* v *Seal*, 56 Tenn. App. 593, 598, 409 S.W.2d 382, 385 (1968) (quoting 37 C.J.S. Fraud § 115 (1943)). *But see Calhoun* v *Baylor*, 646 F.2d 1158, 1163 (6th Cir. 1981) ("The jury was instructed properly that Tennessee law requires proof [of fraud] by only a preponderance of the evidence"); *Gold* v

National Savings Bank of Albany, 641 F.2d 430, 435 (6th Cir. 1981) (quoting the rule established in Jones v. Seal, 56 Tenn.App. 593, 598, 409 S.W.2d 382, 385 (1966): "the facts and circumstances proved [at trial] must clearly establish the inference of fraud.")

6. *West Virginia:*

"It is fundamental that fraud is never presumed but must be established by clear and distinct proof." *General Electric Credit Corp.* v *Fields,* 148 W.Va. 176, 133 S.E.2d 780, 784 (1963).

"In sum, a presumption always exists in favor of innocence and honesty in a given transaction and the burden is upon one who alleges fraud to prove it by clear and distinct evidence. *Hunt* v *Hunt,* 91 W.Va. 685, 114 S.E. 283 (1922)." *Steele* v *Steele,* 295 F.Supp. 1266, 1269 (S.D.W.Va. 1969).

7. *Wyoming:*

"One who alleges fraud must do so clearly and distinctly and prove the same so as to satisfy the mind and conscience of its existence, and fraud will not be imputed to any party when the facts and circumstances out of which it is supposed to arise are consistent with honesty and purity of intention." *Reed* v *Owen,* 523 P.2d 869, 871 (Wyo. 1974); *accord, White* v *Ogburn,* 528 P.2d 1167, 1169 (Wyo. 1974).

E. States which apply different standards depending upon whether action is one at law or in equity:

1. *Arkansas:*

"Clear and convincing evidence of fraud is required to cancel or reform a solemn writing, but not to establish fraud in obtaining a contract by fraudulent misrepresentation. [Citations] The instruction given [that appellee had

the burden of proving fraud by a preponderance of the evidence] was correct since the written instrument involved contained no statement about the vehicle mileage." *Ray Dodge, Inc.* v *Moore,* 251 Ark. 1036, 1041, 479 S.W.2d 518, 521-22 (1972). *But see Bradley* v *Southern Farm Bureau Casualty Insurance Co.,* 392 F.Supp. 478, 483 (E.D.Ark. 1975) ("Fraud is never presumed, but must be affirmatively proven by the party who alleges it by testimony which is clear and convincing.")

2. *New Jersey:*

"Ordinarily, in actions at law fraud must be established by a preponderance of the evidence. [Citation] In equity actions sterner proofs have been required. In such actions proofs must be 'clear and convincing'; 'they must demonstrate a high probability . . . or a strong probability, or that it is *much* more probable than not, that there was fraud.'" *Medivox Productions, Inc.* v *Hoffman-LaRoche, Inc.,* 107 N.J. Super. 47, 69, 256 A.2d 803, 814-15 (N.J.Super.Ct. Law Div. 1969) (Emphasis in original).

"Our requirement that the fraud alleged must be proved by clear and convincing evidence should be noted." *Bilowit* v *Dolitsky,* 124 N.J.Super 101, 304 A.2d 774, 776 (N.J. Super.Ct.Ch.Div. 1973).

3. *Ohio:*

"'In an action for equitable relief, such as to set aside or reform a written contract, or to remove a cloud on the ground of fraud, it seems that clear and convincing evidence of the fraud is required, but in the ordinary action at law based on fraud only a preponderance is required.'" *Household Finance Corp.* v *Altenberg,* 5 Ohio St.2d 190, 193, 214 N.E.2d 667, 669-70 (1966) (quoting Severns v Boylan, 75 Ohio App. 15, 60 N.E.2d 521 (1944)). *But see Central*

Motors Corp. v *City of Pepper Pike*, 63 Ohio App.2d 34, 409 N.E.2d 258, 271 (1979) ("In civil cases, the burden of proof is generally carried by a 'preponderance of the evidence,' which is defined as the greater weight of evidence. A more stringent standard, usually expressed by the term 'clear and convincing' is required to establish an allegation of fraud, a mutual mistake sufficient to justify reformation of an instrument, the existence of a lost will, and similar issues."

STATUTORY APPENDIX

Securities Act of 1933

§ 4, 15 U.S.C. § 77d (1976)

§ 77d. Exempted transactions

The provisions of section 77e of this title shall not apply to —

(1) transactions by any person other than an issuer, underwriter or dealer.

(2) transactions by an issuer not involving any public offering.

(3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except —

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

(B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 77h of this title is in effect as to the security), or such shorter period as the Commission may specify by rules and regulations or order, and

(C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscrip-

tion by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

(4) brokers' transactions executed upon customers' orders on any exchange or in over-the-counter market but not the solicitation of such orders.

§ 5, 15 U.S.C. § 77e (1976)

§ 77e. Prohibitions relating to interstate commerce and the mails

(a) Sale or delivery after sale of unregistered securities

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) Necessity of prospectus meeting requirements of section 77j of this title.

It shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) Necessity of filing registration statement

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use of medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

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§ 11, 15 U.S.C. § 77k (1976)

§ 77k. Civil Liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement

of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue —

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months

beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof —

(1) that before effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and

not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and

(D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for relief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) Effective date of registration statement with regard to underwriters

If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided,* That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefits, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon

the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability

All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) Offering price to public as maximum amount recoverable.

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

§ 12, 15 U.S.C. § 771 (1976)

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

Any person who —

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said

section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

§ 13, 15 U.S.C. § 77m (1976)

§ 77m. Limitation of actions

No action shall be maintained to enforce any liability created under section 77k or 77*l*(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77*l*(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77*l*(1) of this title more than three years after the security was bona fide offered to the public, or under section 77*l*(2) of this title more than three years after the sale.

§ 16, 15 U.S.C. § 77p (1976)

§ 77p. Additional remedies

The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity.

§ 17, 15 U.S.C. § 77q (1976)

§ 77q. Fraudulent interstate transactions

(a) Use of interstate commerce for purpose of fraud or deceit

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) Use of interstate commerce for purposes of offering for sale

It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service,

or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) Exemption of section 77c not applicable to this section

The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

§ 18, 15 U.S.C. § 77r (1976)

§ 77r. State control of securities

Nothing in this subchapter shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person.

§ 24, 15 U.S.C. § 77x (1976)

§ 77x. Penalties

Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this subchapter, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both.

• • •

Securities Exchange Act of 1934

§ 9, 15 U.S.C. § 78i (1976)

§ 78i. Manipulation of security prices

(a) Transactions relating to purchase or sale of security

It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange —

(1) For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the pur-

pose of inducing the purchase or sale of such security by others.

(3) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to induce the purchase or sale of any security registered on a national securities exchange by the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the prices of such security.

(4) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

(5) For a consideration, received directly or indirectly from a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to induce the purchase or sale of any security registered on a national securities exchange by the circulation or dissemination of information to the effect that the price of any such security will or is likely to rise or fall because of the market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security.

(6) To effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) Transactions relating to puts, calls, straddles, or options

It shall be unlawful for any person to effect, by use of any facility of a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors —

(1) any transaction in connection with any security whereby any party to such transaction acquires any put, call, straddle, or other option or privilege of buying the security from or selling the security to another without being bound to do so; or

(2) any transaction in connection with any security with relation to which he has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege; or

(3) any transaction in any security for the account of any person who he has reason to believe has, and who actually has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege with relation to such security.

(c) Endorsement or guarantee of puts, calls, straddles, or options

It shall be unlawful for any member of a national securities exchange directly or indirectly to endorse or guarantee the performance of any put, call, straddle, option, or privilege in relation to any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(d) Registered warrant, right, or convertible security not included in "put", "call", "straddle", or "option"

The terms "put", "call", "straddle", "option", or "privilege" as used in this section shall not include any registered warrant, right, or convertible security.

(e) Persons liable; suits at law or in equity

Any person who wilfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant. Every person who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment. No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

§ 10, 15 U.S.C. § 78j (1976)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§ 18, 15 U.S.C. § 78r (1976)

§ 78r. Liability for misleading statements

(a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person

(not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may use at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

(b) Contribution

Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

(c) Period of limitations

No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

§ 21(e), 15 U.S.C. § 78u (1976)

§ 78u(e). Investigations; Injunctions and prosecution of offenses

(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper court of the United States or the United States

courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

§ 28(a), 15 U.S.C. § 78bb(a) (1976)

§ 78bb. Effect existing law

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more action, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

(Section 11 of the 1933 Act as originally enacted)

CIVIL LIABILITIES ON ACCOUNT OF FALSE REGISTRATION STATEMENT

SEC. 11. (a) In case any part of the registration statement, when such part becomes effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of

such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue —

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof —

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign

from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1), and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, resonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and

that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report of valuation of an expert (other than himself), he had reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, and that such part of the registration statement fairly represented the statement of the expert or was a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true, and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, and that such part of the registration statement fairly represented the statement made by the official person or was a fair copy of or extract from the public official document.

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a person occupying a fiduciary relationship.

(d) If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) The suit authorized under subsection (a) may be either (1) to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or (2) for damages if the person suing no longer owns the security.

(f) All or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

(Title II of the 1934 Act)

TITLE II — AMENDMENTS TO SECURITIES ACT OF 1933

SECTION 201. (a) Paragraph (1) of section 2 of the Securities Act of 1933 is amended to read as follows:

"(1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

(b) Paragraph (4) of such section 2 is amended to read as follows:

"(4) The term 'issuer' means every person who issues or proposes to issue any security; except that with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management, or unit type, the term 'issuer' means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall

not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity; except that with respect to equipment-trust certificates or like securities, the term 'issuer' means the person by whom the equipment or property is or is to be used; and except that with respect to fractional undivided interests in oil, gas, or other mineral rights, the term 'issuer' means the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering."

(c) Paragraph (10) of such section 2 is amended to read as follows:

"(10) The term 'prospectus' means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio, which offers any security for sale; except that (a) a communication shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of section 10 was sent or given to the person to whom the communication was made, by the person making such communication or his principal, and (b) a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section 10 may be obtained and, in addition, does no more than identify the security, state the price thereof, and state by whom orders will be executed."

SEC. 202. (a) Paragraph (2) of section 3 (a) of such Act is amended to read as follows:

"(2) Any security issued or guaranteed by the United States or any Territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories,

or by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States, or any certificate of deposit for any of the foregoing, or any security issued or guaranteed by any national bank, or by any banking institution organized under the laws of any State or Territory or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or Territorial banking commission or similar official; or any security issued by or representing an interest in or a direct obligation of a Federal Reserve bank";

(b) Paragraph (4) of such section 3 (a) is amended by striking out "corporation" and inserting in lieu thereof "person."

(c) Such section 3 (a) is further amended by striking out the period at the end of paragraph (8) and inserting in lieu thereof a semicolon, and by inserting immediately after such paragraph (8) the following new paragraphs:

"(9) Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange;

"(10) Any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental

authority expressly authorized by law to grant such approval;

"(11) Any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory."

SEC. 203. (a) Paragraph (1) of section 4 of such Act is amended (1) by striking out "not with or through an underwriter and"; and (2) by striking out "last" and inserting in lieu thereof "first".

(b) Paragraph (3) of such section 4 is hereby repealed.

SEC. 204. Subsection (c) of section 5 of such Act is hereby repealed.

SEC. 205. Paragraph (1) of section 10(b) of such Act is amended to read as follows:

"(1) When a prospectus is used more than thirteen months after the effective date of the registration statement, the information in the statements contained therein shall be as of a date not more than twelve months prior to such use, so far as such information is known to the user of such prospectus or can be furnished by such user without unreasonable effort or expense."

SEC. 206. (a) section 11 (a) of such Act is amended by adding after the last line thereof the following new sentence: "If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registra-

tion statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person."

(b) Clauses (C) and (D) of paragraph (3) of section 11(b) of such Act are amended to read as follows: "(C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document."

(c) Subsection (c) of such section 11 is amended to read as follows:

"(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable

investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property."

(d) Subsection (e) of such section 11 is amended to read as follows:

"(e) The suit authorized under subsection (a) may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided,* That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were

offered to the public. In any suit under this or any other section of this title the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard."

SEC. 207. Section 13 of such Act is amended (a) by striking out "two years" wherever it appears therein and inserting in lieu thereof "one year"; (b) by striking out "ten years" and inserting in lieu thereof "three years"; and (c) by inserting immediately before the period at the end thereof a comma and the following: "or under section 12(2) more than three years after the sale".

SEC. 208. Section 15 of such Act is amended by inserting immediately before the period at the end thereof a comma and the following: "unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist".

SEC. 209. (a) The first sentence of subsection (a) of section 19 of such Act is amended by inserting after the word "accounting" a comma and the word "technical".

(b) Subsection (a) of such section 19 is further amended by adding at the end thereof the following new sentence: "No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding

that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

SEC. 210. Upon the expiration of sixty days after the date upon which a majority of the members of the Securities and Exchange Commission appointed under section 4 of title I of this Act have qualified and taken office, all powers, duties, and functions of the Federal Trade Commission under the Securities Act of 1933 shall be transferred to such Commission, together with all property, books, records and unexpended balances of appropriations used by or available to the Federal Trade Commission for carrying out its functions under the Securities Act of 1933. All proceedings, hearings, or investigations commenced or pending before the Federal Trade Commission arising under the Securities Act of 1933 shall be continued by the Securities and Exchange Commission. All orders, rules, and regulations which have been issued by the Federal Trade Commission under the Securities Act of 1933 and which are in effect shall continue in effect until modified, superseded, revoked, or repealed. All rights and interests accruing or to accrue under the Securities Act of 1933, or any provision of any regulation relating to, or out of action taken by, the Federal Trade Commission under such Act, shall be followed in all respects and may be exercised and enforced.

SEC. 211. The Commission is authorized and directed to make a study and investigation of the work, activities, personnel, and functions of protective and reorganization committees in connection with the reorganization, readjustment, rehabilitation, liquidation, or consolidation of persons and properties and to report the result of its studies and investigations and its recommendations to the Congress on or before January 3, 1936.

Respondent's Brief

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Nos. 81-680, 81-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

HERMAN & MACLEAN,

Petitioner,

v.

Ralph E. HUDDLESTON and Chester E. Bradley, Jr., *et. al.*,

Respondents.

Ralph E. HUDDLESTON and Chester E. Bradley, Jr., *et. al.*,

Petitioners,

v.

HERMAN & MACLEAN, Lawrence H. LoPatin, and Leslie Share,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RALPH E. HUDDLESTON AND CHESTER E. BRADLEY, JR., *ET AL.*, AS RESPONDENTS IN No. 81-680 AND PETITIONERS IN No. 81-1076

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QUESTIONS PRESENTED FOR REVIEW

1. (No. 81-680) Does an implied cause of action for the fraudulent sale of securities exist under section 10(b) of the Securities Exchange Act of 1934 when purchasers may have express remedies under other provisions of the federal securities laws?

2. (No. 81-1076) Is preponderance of the evidence the appropriate standard of proof in private section 10(b) actions?

PARTIES

Plaintiffs – appellees in the Court below – are Ralph E. Huddleston, Chester E. Bradley, Jr., individually and as class representatives, the class they represent, and David M. Kemp, Thomas F. Plant, Felton F. Waggoner, Jack H. Barrett, and Daryl Lostax. Defendants – appellants in the Court below – are Herman & MacLean, certified public accountants, Lawrence H. LoPatin, and Leslie Share.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

Nos. 81-680, 81-1076

HERMAN & MACLEAN,

Petitioner,

v.

Ralph E. HUDDLESTON and Chester E. Bradley, Jr., *et. al.*,

Respondents.

Ralph E. HUDDLESTON and Chester E. Bradley, Jr., *et. al.*,

Petitioners,

v.

HERMAN & MACLEAN, Lawrence H. LoPatin, and Leslie Share,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RALPH E. HUDDLESTON AND CHESTER E. BRADLEY, JR., *ET AL.*, AS RESPONDENTS IN No. 81-680 AND PETITIONERS IN No. 81-1076

Ralph E. Huddleston and Chester E. Bradley, Jr., individually and as designated class representatives, and David M. Kemp, Thomas F. Plant, Felton F. Waggoner, Jack H. Barrett, and Daryl Lostax, submit this Brief pursuant to the writs of certiorari that were granted by this Court in No. 81-680 and No. 81-1076, both of which challenge aspects of the decision of the United States Court of Appeals for the Fifth Circuit in the case of *Huddleston v. Herman & MacLean,* 640 F.2d 534.

OPINION BELOW

The opinion of the Court of Appeals is reported at 640 F.2d 534 and is set forth in the Appendix to the petition for a writ of certiorari filed by Herman & MacLean, No. 81-680. App. A, No. 81-680.[1] The opinion of the Court of Appeals denying the petition for rehearing and for rehearing *en banc* filed by Huddleston and Bradley, *et al.*, is unreported and is set forth in the Appendix in No. 81-680. App. B, No. 81-680. The District Court issued no opinion. It did render a final judgment dated October 16, 1979. App. C, No. 81-680.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1981. App. A-1, No. 81-680. A timely petition for rehearing and for rehearing *en banc* was denied on July 13, 1981. App. B-1, No. 81-680. Herman & MacLean timely filed its petition for a writ of certiorari, No. 81-680, on October 8, 1981. Ralph E. Huddleston and Chester E. Bradley, Jr., *et al.*, timely filed their petition for a writ of certiorari, No. 81-1076, on December 10, 1981, following an order by this Court extending the time within which to file the petition. This Court granted the writs of certiorari on April 5, 1982, and has jurisdiction to review the decision of the United States Court of Appeals for the Fifth Circuit under 28 U.S.C. § 1254(1).

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[1]References to the Appendix filed with the petition in No. 81-680 are identified as "App. ____, No. 81-680." References to the Appendix filed with the petition in No. 81-1076 are identified as "App. ____, No. 81-1076."

STATUTES AND REGULATIONS INVOLVED

The following statutes and regulations are pertinent to this case: section 11 of the Securities Act of 1933, 15 U.S.C. § 77k; section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 (1981). The text of these provisions is found in the statutory appendix to the Brief of Herman & MacLean.

STATEMENT OF THE CASE

In 1969 Texas International Speedway, Inc. ("TIS"), a Texas corporation, filed a registration statement and prospectus with the SEC in connection with the proposed sale to the public of $4,398,900 in securities, the proceeds of which were to be used to pay for the construction of an automobile speedway and its initial operations. J.A. 156a.[2] The securities were offered and sold in $1,333 units consisting of 100 shares of common stock at $3.33 per share and a $1,000 debenture. *Id.* The registration statement became effective on October 30, 1969, J.A. 158a, and the entire issue was sold to the public on that date through an underwriting syndicate. T. 241-242, 275-276. TIS stock was a "hot issue" and was heavily traded, reaching a price as high as $12 per share. T. 306-307. However, the corporation filed a petition for Chapter X bankruptcy thirteen months later, on November 30, 1970.

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[2]References to the Joint Appendix filed herewith are identified by "J.A."; transcript references are preceded by "T"; and references to trial exhibits are identified as "Pl. Ex."

Plaintiffs[3] Huddleston and Bradley, on behalf of themselves and other purchasers of TIS securities[4] filed a class action suit in 1972, seeking damages from defendant LoPatin, the former president, treasurer, and director of TIS; from defendant Share, the former executive vice-president and director of TIS; from defendant Herman & MacLean, the certified public accountants for TIS; and from others who are no longer parties to this action.[5] J.A. 17a-18a. The complaint alleged, *inter alia,* violations of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 (1981).[6] J.A. 19a.

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[3]Because Herman & MacLean and Huddleston and Bradley, *et. al.*, are both petitioners and respondents, Huddleston and Bradley, *et al.*, are referred to as plaintiffs, and Herman & MacLean, Lawrence LoPatin, and Leslie Share as defendants.

[4]The plaintiff class consists of those persons who received the TIS prospectus and purchased TIS securities between October 30, 1969 and January 28, 1970. J.A. 70a.

[5]With court approval, plaintiffs compromised their claims against the underwriters of the TIS securities, the attorneys for the underwriters, and the principal speedway contractor. J.A. 101a.

[6]Plaintiffs also originally sought relief under section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). It is unnecessary, however, to decide whether an implied cause of action exists under that provision, an issue that was reserved in International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 557 n.9 (1979). Plaintiffs pleaded scienter, J.A. 25a; the charge of the trial court required a finding of scienter, J.A. 145a-147a, 149a-151a; the jury found scienter, App. A, No. 81-1076; and the Court of Appeals found the evidence sufficient to establish scienter. App. A-18-19, No. 81-680. Plaintiffs have abandoned their section 17(a) claim by failing to object to the trial court's charge requiring scienter. The existence of an implied cause of action under section 17(a) is therefore not an issue in this case.

Plaintiffs' essential claim was that Herman & MacLean with the other defendants agreed upon a fraudulent scheme to deceive and a course of intentional conduct to misrepresent and conceal material facts regarding the financial condition of TIS, which would have revealed TIS' insolvency after the public offering. J.A. 24a-28a.

Herman & MacLean participated in the preparation of the use of proceeds section and pro forma balance sheet, both of which contain material misrepresentations, and was a participant in the preparation of responses to SEC letters of comment on the TIS registration statement. T. 576, 581, 613, 617-623, 792-794; *see* J.A. 273a, J.A. 284a. However, the October 27, 1969 opinion of Herman & MacLean included in the TIS prospectus states that the May 31, 1969 balance sheet and related financial statements "present fairly" the financial position of TIS. J.A. 213a. The opinion also states that the pro forma balance sheet as of May 31, 1969 "presents fairly" the financial position of TIS after giving effect to the pro forma transactions. *Id.*

Plaintiffs claimed that the fraudulent scheme was perpetrated through the use of the prospectus which was misleading in four respects.

First, the pro forma balance sheet dated May 31, 1969 falsely stated that $93,870 would be available to TIS after taking into account the net proceeds of the offering and deducting estimated construction costs. In fact, the working capital figure was overstated by almost $500,000; the true figure would have shown a projected working capital deficit in excess of $400,000.

Second, the use of proceeds section also overstated by the same amount the available working capital as of September 15, 1969, after taking into account the net pro-

ceeds of the offering and deducting actual construction costs incurred subsequent to May 31, 1969 and remaining costs to complete the Speedway.

Third, the opinion of the consulting engineer, which purported to give assurance as to the construction cost estimates in the use of proceeds section, failed to disclose that it was made without adequate investigation of those estimates.

Fourth, the audited financial statements failed to disclose a loan of $100,000 made to TIS on October 21, 1969, by an affiliate of the general contractor of the Speedway. This omission materially altered the financial picture of TIS. *See* J.A. 168a-169a, 211a, 213a, 217a-218a.

In February and April 1969, Herman & MacLean received preliminary estimates of projected costs for construction of the Speedway. J.A. 258a; T. 565. Basing its analysis on these estimates, it concluded in a letter to Leslie Share dated May 20, 1969 that the construction costs and administrative expenses would exceed the proceeds of the offering by $488,000. J.A. 257a; T. 534-541. In early June 1969, the accountants met with defendants LoPatin and Share at which time the construction cost estimates were pared in order to create a positive working capital for the TIS prospectus. J.A. 267a; T. 541-545, 550. Plaintiffs asserted that these reductions were wholly without foundation in view of known construction needs and were, indeed, a sham. T. 129, 1658-1660. That same month, the person responsible for supervising construction at the Speedway prepared a revised estimate that exceeded the estimates employed in the prospectus. Pl. Ex. 21, T. 489, 490; T. 968-973. The actual construction costs, known in January 1970, exceeded the estimates by $483,000, approximately $5,000 less than the overrun pro-

jected by Herman & MacLean in May 1969. Pl. Ex. 41, T. 700; Pl. Ex. 42, T. 713; J.A. 344a. These facts, as plaintiffs asserted, T. 139, showed that Herman & MacLean was party to a conspiracy to understate fraudulently the Speedway construction costs.

Although the TIS underwriting agreement required Herman & MacLean to provide a comfort letter concerning the construction costs, J.A. 327a-328a, the accountants refused to comply. T. 674-675. The comfort letter that Herman & MacLean did sign made no reference to construction costs. T. 684; J.A. 337a. At a meeting in which Herman & MacLean participated, it was decided to engage a firm of consulting engineers which would provide a letter affirming the accuracy of the construction estimates, J.A. 255a, 256a; T. 935-936, 1397-1399, and agree to use of its name in the prospectus. J.A. 170a, 211a.

As part of the alleged conspiracy, Herman & MacLean did not follow generally accepted auditing standards, which require post-balance sheet reviews of events and transactions prior to the issuance of a report. T. 1044-1049, 1076-1079. As a result the TIS prospectus did not reveal a $100,000 loan made to TIS by Holloway Construction Co., which had the same ownership and management as the principal contractor for the Speedway, Holloway Sand & Gravel Co. Pl. Ex. 67, T. 1623. The purpose of the loan was to satisfy TIS' immediate cash needs. T. 1390. Disclosure of this loan would have informed investors of TIS' precarious financial condition.

After the closing of the TIS offering, the only professional to receive its fees was Herman & MacLean. J.A. 345a; T. 718-720. And in December 1969, Herman & MacLean obtained a letter from LoPatin releasing the firm from "any responsibility" it might have to TIS in con-

nection with the comfort letter provided to the underwriters. J.A. 343a; T. 691-695.

The case was submitted to the jury on special interrogatories relating solely to liability, upon a charge that liability could be found only if the defendants engaged in conduct with scienter, that is, with intent to deceive or with reckless disregard for the truth.[7] The jury was also instructed to reach its verdict by a preponderance of the evidence. J.A. 142a-143a. In answers that were internally consistent, the jury found, *inter alia,* 1) that the TIS prospectus was materially misleading as to the construction costs for the Speedway and the working capital position of TIS as set forth both in the pro forma balance sheet and use of proceeds section; 2) that LoPatin, Share, and Herman & MacLean with reckless disregard for the truth failed to make proper disclosure concerning these matters; 3) that LoPatin and Share, with an "intent to deceive or defraud," were responsible for the materially false and misleading working capital statement set forth in the pro forma balance sheet and for failing to disclose the receipt by TIS of the $100,000 loan from Holloway Construction; 4) that Share caused an engineering firm to furnish an opinion with respect to estimated construction costs without

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[7]The trial court defined the term "reckless disregard for the truth" as

> conduct which is so extreme as to be a form of intentional conduct or behavior equivalent to an intent to deceive, manipulate or defraud. To be equivalent to such intent, recklessness must be conduct which is highly unreasonable, involving not merely simple or even inexcusable negligence but extreme departure from the standards of ordinary care and which presents a danger of misleading buyers or sellers that is either known to the Defendant or is so obvious that the Defendant must have been aware of it.

J.A. 149a.

requiring it to perform due diligence procedures to determine the accuracy of these estimates; and 5) that Herman & MacLean aided and abetted the fraudulent and unlawful conduct of LoPatin and Share, who were found to be controlling persons of TIS. App. A, No. 81-1076.

Following the jury's finding of liability against defendants, the trial court determined damages, awarded attorney's fees, and entered judgment for plaintiffs. App. C, No. 81-680.

On appeal, the United States Court of Appeals reversed and remanded for a new trial, *inter alia,* on the ground that the trial court had failed to submit the issues of reliance and causation to the jury. App. A-23, No. 81-680. However, relying on *Fischman v. Raytheon Manufacturing Co.,* 188 F.2d 783 (2d Cir. 1951), the "classic reconciliation of the apparent overlap of the express civil liability provisions of the 1933 Act and the cause of action implied in Rule 10b-5," the Court upheld the existence of the section 10(b) remedy in this case. App. A-7, No. 81-680. Because a new trial was required in any event, the Court ruled *sua sponte* that under section 10(b), the appropriate burden of proof is the "clear and convincing" standard, not the "preponderance of evidence" standard used by the trial court. App. A-17, No. 81-680. The Court did point out that "even under [the higher] standard, the jury could infer from the evidence presented that the defendants had acted with the requisite scienter . . . ." App. A-18, No. 81-680.[8]

[8]Reviewing the evidence, the Court held that "the jury might reasonably have concluded from Herman's testimony and from any inference to be drawn from his involvement in the preparation of the Use of Proceeds section of the prospectus, as well as from the refusal of H&M in October, 1969, to provide a comfort letter to the underwriters referring to the construction costs in the prospectus, that H&M acted with the requisite scienter." App. A-18-19, No. 81-680.

I. No. 81-680

SUMMARY OF ARGUMENT

Plaintiffs had no express remedy under the federal securities acts, including section 11 of the 1933 Act, to redress all the unlawful conduct of Herman & MacLean. The reach of accountants' section 11 liability extends no further than the portions of the registration statement they purport to prepare or certify. Only one of the four material misrepresentations or omissions in the TIS prospectus clearly is an expertised statement that gives rise to a cause of action under section 11; a second is probably not actionable under section 11; the remaining two of Herman & MacLean's fraudulent acts are actionable solely under section 10(b). Therefore, the record in this case does not raise the issue of overlapping implied and express remedies, since plaintiffs in this case could not have obtained complete redress under the express section 11 remedy. The question this case presents instead is whether an implied section 10(b) cause of action is available for fraud in the sale of registered securities, regardless of the existence of express remedies.

A section 10(b) private cause of action is not defeated by the existence of alternative express remedies. Because the Supreme Court has upheld an implied cause of action under section 10(b), the question is whether, given the existence of the implied remedy, Congress would deny it because an express remedy is available. That Congress would not is made clear by the language of section 10(b) and the legislative scheme of the 1933 and 1934 Acts. Section 10(b)'s prohibition against fraud in the "purchase or sale of any security" does not exclude fraud committed in the issuance of registered securities. Sections 10(b) and 11 constitute fundamentally different causes of action,

designed to remedy different types of wrongdoing. In contrast to the narrow duty to ensure the accuracy of registration statements imposed by section 11, a section 10(b) cause of action creates liability for any fraud. The strict procedural safeguards of section 11, which requires only a showing of negligence, are not nullified by section 10(b), which requires proof of scienter. Moreover, denial of a section 10(b) cause of action to purchasers of registered securities, either when express remedies are available or when they are not, would be unfair and would create procedural complexity.

Since the leading case of *Fischman v. Raytheon Manufacturing Co.*, 188 F.2d 783 (2d Cir.), was decided in 1951, virtually all lower federal courts have agreed that section 10(b) affords a civil remedy to defrauded purchasers of securities despite the existence of express remedies under the 1933 Act. In three revisions of the securities acts, Congress has not sought to overrule this decision. This Court should endorse the thirty-year-old *Fischman* doctrine, uniformly accepted by the courts and implicitly approved by Congress.

ARGUMENT

Introduction

This Section of the Brief addresses the question presented in No. 81-680: whether the implied private cause of action under section 10(b) exists when other, express remedies are available under the federal securities laws. Some initial explanatory comments may be helpful to the Court in analyzing this issue.

First, it is not entirely clear what holding Herman & MacLean seeks from this Court. Because Herman &

MacLean casts the question it presents as one involving the overlap between express and implied remedies, it appears to seek a ruling that an implied remedy under section 10(b) is available only when no express remedy exists. Elsewhere in its Brief Herman & MacLean appears to request a holding that "no implied remedy under § 10(b) exists for registered offerings of securities," Brief at 37, regardless of whether purchasers have any other remedy for unlawful conduct. *See also id.* at 42. The ramifications of these alternative rulings would be very different.

Second, although Herman & MacLean initially accepts the existence of an implied cause of action under section 10(b), Brief at 9-10, it goes on to argue nevertheless that "[n]either the language of § 10(b) nor the legislative history of the 1934 Act suggests a Congressional intent to imply a private cause of action for violations of § 10(b)." *Id.* at 19. From this premise, of course, it logically follows that the 1934 "Congress did not intend to provide a private remedy which would duplicate the express remedy provided in § 11 of the 1933 Act." *Id.* This argument proves too much. Without assuming the existence of the section 10(b) implied action, how Congress would have resolved the question of overlapping remedies cannot intelligently be ascertained.

This Brief will proceed on a different course. Part A demonstrates that section 11 does not provide a remedy for all of the unlawful conduct of Herman & MacLean and that this case, therefore, does not present the question of overlapping express and implied remedies.

Part B begins by showing that the existence of an implied cause of action under section 10(b) has been repeatedly affirmed by this Court, most recently in a case decided this past Term. Unlike the argument of Herman &

MacLean, Part B then analyzes whether, on the continuing assumption that a section 10(b) remedy is available under some circumstances, Congress would intend to deny that remedy either when purchasers of registered securities have an express section 11 remedy or when they do not.

Part C concludes by arguing that both the policy of *stare decisis* and Congress' failure to amend the federal securities acts support a decision upholding the existence of section 10(b) remedies even when other, express remedies are available under the federal securities laws.

A. Plaintiffs Did Not Have A Cause Of Action Under Section 11 Of The 1933 Act For All Of The Fraudulent Conduct Committed By Herman & MacLean.

The Court of Appeals asserted without discussion that the "alleged misrepresentations in the prospectus would also warrant a suit" by plaintiffs against Herman & MacLean under section 11. App. A-6, No. 81-680. In fact, of the four particulars in which the TIS prospectus was materially false and misleading, Herman & MacLean would have section 11 liability for only one; for two others, Herman & MacLean would clearly have no section 11 liability; and for the fourth, the issue is in doubt.

Section 11(a)(4) of the Securities Act of 1933, 15 U.S.C. § 77k(a)(4), makes liable

> every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration

> statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him.

Unlike the issuer of the security, the signers of the registration statement, the directors of the issuer, or the underwriters, who are liable for material inaccuracies in the whole of the registration statement, *see* section 11(a)(1), (2), (3), (5), section 11(a)(4) effectively allows accountants and other experts to define for themselves the breadth of their section 11 liability. An accountant is liable only for statements that he "purportedly" has prepared, and what he has prepared is determined from the "four corners of the prospectus." *Grimm v. Whitney-Fidalgo Seafoods, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 96,029, at 91,608 (S.D.N.Y. 1973).

Although there is a paucity of case law on the subject, the lower courts have protected accountants and other experts from expansive claims of liability under section 11. In the leading case of *Escott v. BarChris Construction Co.*, 283 F. Supp. 643 (S.D.N.Y. 1968), the plaintiff class sued the accountant under section 11 for materially false information contained in the prospectus. Some of the parties claimed that the accountant was responsible for "every figure in the prospectus." *Id.* at 683. The district court rejected that contention.

> Here again, the more narrow view is the correct one. The registration statement contains a report of [the accountant] dated February 23, 1961. This relates only to the consolidated balance sheet of BarChris and consolidated subsidiaries as of December 31, 1960, and the related statement of earnings and retained earnings for the five years then ended. This is all that [the ac-

> countant] purported to certify. It is perfectly clear that it did not purport to certify the 1961 figures, some of which are expressly stated in the prospectus to have been unaudited.

Id. at 684.

Similarly, in *McFarland v. Memorex,* 493 F. Supp. 631 (N.D. Cal. 1980), accountants were sued for misleading financial information contained in a prospectus. "[T]he accountants are named in the registration statement as having prepared or certified only the consolidated financial statements for the years 1974 through 1977. The complaint . . . challenges the 1978 financial information. The registration statement prominently labels all financial statements or summaries of operations for 1978 as 'unaudited.' Because of this, the accountants can bear no section 11 liability for any misstatement of the 1978 financial data." *Id.* at 643 (footnote omitted); *see also Grimm, supra,* at 91,608-09 (the accountant's liability is limited to "certified financial statements").[9]

The opinion of Herman & MacLean set forth in the prospectus establishes the reach of its expert review. According to the opinion, Herman & MacLean "examined" the May 31, 1969 balance sheet of TIS. J.A. 213a. It also "reviewed the pro forma balance sheet as of May 31, 1969 . . . ." *Id.*

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[9] *Cf.* Commission Rule 436(c), (d), 17 C.F.R. § 230.436(c), (d) (1981) (unaudited, interim reports included in registration statement shall not be considered as "prepared or certified by an accountant within the meaning of" section 11).

Of the four particulars in which the prospectus was materially false and misleading, *see* pp. 5-6, *supra*, only one could clearly form the basis of section 11 liability. The audited financial statements, which Herman & MacLean certified in its opinion, failed to disclose a material loan of $100,000 made to TIS by an affiliate of the general contractor.

Two other false and misleading statements, however, were not contained in statements purportedly prepared or certified by Herman & MacLean. First, the use of proceeds section falsely stated the amount of cash available for general corporate purposes that would be available to TIS after the offering. Although Herman & MacLean was involved in preparing the use of proceeds section, its opinion does not purport to review that section. *See* J.A. 213a. Second, the opinion of the expert consulting engineers concerning estimated construction costs failed to disclose that it was made without an adequate investigation of those estimates. Again, Herman & MacLean's opinion does not purport to review construction estimates; indeed, the accountants refused to provide the underwriters with an opinion concerning those estimates. *See* p. 7, *supra*. Nevertheless, because Herman & MacLean was involved in paring the original cost estimates, it knew or was recklessly indifferent to the inaccuracy of the estimates certified by the engineers. Under *Escott, McFarland,* and *Grimm, supra,* it is thus clear that section 11 does not provide a remedy against Herman & MacLean for these material misstatements and misrepresentations.

The fourth material misstatement was contained in the pro forma balance sheet concerning the amount of cash that would be available to TIS following the stock issue. Herman & MacLean's opinion states that the pro forma

balance sheet was "reviewed" and "presents fairly" the financial position of TIS on May 31, 1969, after giving effect to the pro forma transactions. J.A. 213a. Nevertheless, the pro forma balance sheet distinguishes between the "historical balance sheet," which was audited, and the "pro forma transactions," which are merely mechanical projections based upon the assumptions contained in the notes to the financial statements. J.A. 217a-220a. Under the relevant case authority cited above, there is substantial doubt whether Herman & MacLean could be found liable under section 11 for the misstatement found in the pro forma balance sheet.

Herman & MacLean itself apparently concedes that plaintiffs had no section 11 remedy to redress all of its fraudulent conduct. "[P]laintiffs asserted liability as to Herman & MacLean for alleged misrepresentations or omissions with respect to materials in the prospectus not covered by its opinion and therefore not providing a § 11 basis for liability." Brief at 24.

The remedies of section 11 are not coextensive with the unlawful conduct of Herman & MacLean. Although section 11 provides a remedy for one or possibly two unlawful acts, that section does not encompass the scheme to defraud. Thus, because some of the conduct is not actionable under both sections 10(b) and 11, the question of overlap is not presented by this case. Rather, this case presents the question whether an implied section 10(b) remedy is to be denied when fraud is committed in connection with an offer of registered securities, regardless of whether an express remedy exists.

B. An Implied Private Cause Of Action For The Fraudulent Sale Of Securities Exists Under Section 10(b) And Rule 10b-5 Notwithstanding The Availability Of Express Remedies Under Provisions Of The Securities Act Of 1933.

The existence of a private cause of action under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 can no longer be seriously challenged. Neither section 10(b) nor Rule 10b-5 explicitly provides a private cause of action. Beginning with *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), however, the lower federal courts with little dissent have implied a private section 10(b) action in order to further the remedial purposes of the securities acts. Although the Supreme Court has never itself decided the existence of a private section 10(b) remedy, twenty-five years after *Kardon* it affirmed the consensus of the lower courts: "[i]t is now established that a private right of action is implied under § 10(b)."[10] *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971). "Such a conclusion was, of course, entirely consistent with the Court's recognition in *J.I. Case v. Borak*, 377 U.S. 426, 432 (1964), that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'" *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (bracketed language in the original).

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[10]Neither Herman & MacLean, nor any of the amici filing briefs on its behalf disputes this proposition. *E.g.*, Brief of Herman & MacLean at 9-10. Herman & MacLean does suggest that were the Court to examine today the existence of an implied cause of action under section 10(b), "it is not unlikely that the Court would refuse to infer a private right of action . . . ." *Id.* at 12. Whatever merit this contention may have, it has no relevance to the case at bar.

Since *Superintendent* the Court has characterized the private section 10(b) action as "confirmed," *Blue Chip Stamps, supra,* 421 U.S. at 730, and "well established." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 196 (1976). *See also Steadman v. SEC,* 450 U.S. 91 (1981); *Aaron v. SEC,* 446 U.S. 680, 689 (1980); *Touche Ross & Co. v. Redington,* 442 U.S. 560, 577 n.19 (1979); *Cannon v. University of Chicago,* 441 U.S. 677, 690 n.13 (1979); *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 477 (1977); *Piper v. Chris-Craft Industries, Inc.,* 430 U.S. 1, 25 (1977); *Affiliated Ute Citizens v. United States,* 406 U.S. 128 (1972); *SEC v. National Securities, Inc.,* 393 U.S. 453 (1969). Last Term in a case involving a private cause of action under the Commodity Exchange Act, the Court found that the private section 10(b) suit had achieved "routine acceptance." *Merrill Lynch, Pierce, Fenner & Smith v. Curran,* 102 S. Ct. 1825, 1840 (1982); *see id.* at 1845 n.88, 1846 n.92.

Having upheld the existence of a private section 10(b) remedy, the Court must now decide whether that remedy is defeated by the availability of express remedies under the federal securities acts. In construing the breadth of section 10(b), "[t]he ultimate question is one of congressional intent[.]" *Touche Ross & Co., supra,* 442 U.S. at 578; *see Middlesex County Sewerage Authority v. National Sea Clammers Ass'n,* 453 U.S. 1, 13 (1981).

There is no direct evidence of congressional intent to imply a private remedy under section 10(b). As the Court observed in *Hochfelder, supra,* the legislative history of the 1934 Act is "bereft of any explicit explanation of Congress' intent." 425 U.S. at 201. The administrative history of Rule 10b-5 is no more illuminating. Thus, "it would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 fore-

ordained the present state of the law with respect to Rule 10b-5." *Blue Chip Stamps, supra,* 421 U.S. at 737.

Herman & MacLean seizes upon the lack of legislative intent to create a private section 10(b) remedy to support the proposition that "Congress did not intend to provide a private remedy which would duplicate the express remedy provided in § 11 of the 1933 Act." Brief at 19. Of course it is logically true that if Congress did not intend to create a private section 10(b) remedy at all, it could not have intended to allow that remedy when an express remedy is available. This analysis, however, is flawed. The proper inquiry is not what the 1934 Congress in fact intended. Rather, the inquiry is what Congress would intend had it known that eight years later the courts would imply a private section 10(b) remedy. Obviously this question cannot be ascertained directly from the legislative history of the 1934 Act. But how Congress would reasonably have answered it can be determined by an examination of the language of section 10(b) and the remedial structure of the 1933 and 1934 Acts, and by considerations of policy.[11]

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[11]The Court identified four criteria in Cort v. Ash, 422 U.S. 66, 78 (1975), for determining the existence *vel non* of implied causes of action, all of which center upon the intent of Congress. The *Cort* test does not assist the present inquiry, where an implied remedy is recognized and only its reach is in question. Thus, the Court stated in *Blue Chip Stamps, supra,* that because the section 10(b) action has been "judicially found to exist," the Court is free in "judicially delimit[ing]" it to rely upon "practical factors" and "policy considerations." 421 U.S. at 749. These considerations are helpful in determining how Congress would have delimited the reach of the private section 10(b) action. *See Piper, supra,* 430 U.S. at 55 n.4 (Stevens, J., dissenting) (because the section 10(b) private remedy must now be assumed, its interpretation does not "present the same kind of issue discussed in *Cort*"), *quoted in Curran, supra,* 102 S. Ct. at 1846 n.92.

Section 10(b) makes it unlawful

> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

The language of the provision does not distinguish between purchases and sales of securities; equally prohibited are fraudulent devices in connection with the "purchase or sale" of any security. That purchasers were to be protected by section 10(b) is reenforced by the delegation of authority to the SEC to prescribe rules necesary for the protection of "investors." In addition, the section comprehends transactions involving any type of security; securities purchased pursuant to a registration statement are not excluded. The all-inclusive language of this provision does not carve out an exception for defrauded purchasers or sellers who may have express remedies under section 11 or any other provision of the federal securities acts.

Section 11 of the 1933 Act and section 10(b) of the 1934 Act create fundamentally different causes of action. Section 11 provides an express cause of action to investors who purchase securities issued under a registration statement containing material misstatements or omissions. The provision makes liable the issuer of the security, directors or partners of the issuer, underwriters, every person who signs the statement, and engineers, accountants, and others who provide expert opinions in the statement.

Recovery for material misstatements under section 11 is substantially easier than was true under the common law

or at equity. To establish a prima facie case, a plaintiff need only show that he purchased a security registered under a statement containing an untrue statement of material fact or an omission of a material fact necessary to make the statement not misleading. As this Court explained in *Hochfelder, supra,* "[w]ithin the limits specified by § 11(e), the issuer of the securities is held absolutely liable for any damages resulting from such misstatement or omission." 425 U.S. at 208. All other defendants are accorded a "due diligence" defense. Section 11(b). *See Escott, supra,* 283 F. Supp. at 682-83.

Because of the substantial potential liability that section 11 creates for those associated with the filing of registration statements and because of the ease with which a cause of action is established, Congress added by amendment in 1934, *inter alia,* two rigorous procedural restrictions limiting the section 11 action. First, it established a short statute of limitations: one year from the date of discovery of the material misstatement or omission and, in any event, no more than three years from the date the security was offered.[12] Section 13, 15 U.S.C. § 77m. This provision was designed to prevent purchasers from delaying suit in order to speculate upon the market value of the security. *See* 78 Cong. Rec. 8199 (1934) (remarks of Senators Kean and Norris). Second, Congress authorized the courts in their discretion to require plaintiffs to post a bond for costs, including attorney's fees. Section 11(e). *See, e.g., Fischman, supra,* 188 F.2d at 788-89.

In sum, section 11 eased the requirements that purchasers of registered securities must meet in order to

[12]Herman & MacLean asserts that plaintiffs filed suit under section 10(b) because the statute of limitations governing section 11 had expired. Brief at 4. As part A, *supra,* makes clear, plaintiffs did not have a complete remedy under section 11 against Herman & MacLean.

recover damages for material misstatements contained in registration statements. The provision substitutes a "negligence standard," *Hochfelder, supra,* 425 U.S. at 208, for the onerous burdens imposed under the common law of fraud: proof of privity, scienter, loss causation,[13] and reliance[14] are not required under section 11. *See* III L. Loss, *Securities Regulation* 1430-35, 1624-28, 1729 (2d Ed. 1961); Shulman, *Civil Liability and the Securities Act,* 43 Yale L.J. 227, 248-49 (1933).

In contrast with section 11 of the 1933 Act, section 10(b) of the 1934 Act as interpreted by the courts requires proof of most of the elements of common law deceit. First, unlike the negligence standard of section 11, the gravamen of a section 10(b) action is deception or fraud. In *Hochfelder, supra,* the Supreme Court held that proof of scienter is a necessary element of the section 10(b) cause of action.[15] The Court drew on both the language of the pro-

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[13]A defendant may reduce his liability by proving that the plaintiff's damages were not attributable to the material misstatement or omission contained in the registration statement. Section 11(e).

[14]If the plaintiff purchases the security after the issuer has published an earnings statement for the twelve-month period following the effective date of the registration statement, then he must prove reliance. Section 11(a).

[15]Amicus Securities Industry Association contends that the courts have "diluted" the scienter requirement of section 10(b) by including "reckless" behavior. Brief at 24. As the Court observed in *Hochfelder, supra,* 425 U.S. at 193 n.12, "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." *See, e.g.,* New York Times Co. v. Sullivan, 376 U.S. 254, 279-80 (1964) (holding that "reckless disregard" for truth is sufficient to show "actual malice" under the First Amendment); *see generally* United States v. Bailey, 444 U.S. 394 (1980). False statements made recklessly are sufficient to show intention under the common law action for deceit. *E.g.,* Burgundy Basin Inn, Ltd. v. Watkins Glen Grand Prix Corp., 51 A.D.2d 140, 379 N.Y.S.2d 873 (N.Y. App. Div. 1976). The *Hochfelder* Court reserved

vision and the sparse legislative history to buttress its holding. As the Court noted, "the words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Hochfelder, supra,* 425 U.S. at 197; *see Aaron, supra,* 446 U.S. at 691. The legislative history, too, indicates that section 10(b) was "addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone." *Hochfelder, supra,* 425 U.S. at 201. *See* Hearings on H.R. 7852 and 8720 before the House Interstate and Foreign Commerce Committee, 73d Cong., 2d Sess. 115 (1934); *Hochfelder, supra,* 425 U.S. at 201-06.

Second, the element of reliance, absent in section 11, is part of the section 10(b) cause of action. Although the Supreme Court has held that in certain circumstances reliance may be presumed, *Affiliated Ute, supra,* 406 U.S. at 153-54; *see Shores v. Sklar,* 647 F.2d 462 (5th Cir. 1981), *petition for cert. filed,* 50 U.S.L.W. 3377 (U.S. Nov. 10, 1981) (No. 81-839), the presumption "does not eliminate the reliance element from the Rule 10b-5 case altogether." App. A-20-21, No. 81-680.

Third, a section 10(b) plaintiff must prove loss causation, as the lower federal courts have held. *See, e.g., Huddleston, supra,* 640 F.2d at 549; *List v. Fashion Park, Inc.,* 340 F.2d 457, 463 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965). By contrast, under section 11 the absence of loss causation is an affirmative defense. Section 11(e).

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the question whether recklessness suffices for purposes of civil liability under section 10(b), 425 U.S. at 193 n.12, a question that is not at issue in this case. *See* note 7, *supra.*

Finally, because an action under section 10(b) is one for fraud, a complaint alleging a violation of that provision must state "with particularity" the circumstances constituting fraud. Rule 9(b), Fed. R. Civ. P. This procedural barrier is designed to discourage the filing of groundless claims solely for their *in terrorem* effect. *Ross v. A.H. Robins Co.*, 607 F.2d 545, 557 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *see also Segal v. Gordon*, 467 F.2d 602, 608 (2d Cir. 1972); *Fischman, supra*, 188 F.2d at 787 n.6.

The elements of sections 10(b) and 11 reflect the different purposes they were designed to serve. Section 11 is a narrowly drawn provision that imposes upon individuals connected with the preparation of a registration statement the duty to assure the accuracy of information contained therein. In accord with the general goals of the 1933 Act to provide full and fair disclosure to investors in the issuance of new securities, section 11 was enacted to furnish "a remedy to all purchasers who may reasonably be affected by any statements in the registration statement." H.R. Rep. No. 85, 73d Cong., 1st Sess. 22 (1933). One of the principal purposes of the 1933 Act was a requirement that the "persons, whether they be directors, experts, or underwriters, who sponsor the investment of other people's money should be held up to the high standards of trusteeship." *Id.* at 3. Congress was so concerned for the accuracy of registration statements that upon those involved in their issuance it imposed a "duty of competence" and corresponding liability for negligence.[16] "For those

[16]Section 11(e) prohibits an award of damages "exceeding the price at which the security was offered to the public." In 1934 Congress added an amendment to the provision that limits the liability of underwriters arising from an issue of securities to the amount of securities they actually underwrote. Section 10(b), by contrast, contains no comparable limitations on liability. The difference is neither irrational nor

whose moral responsibility to the public is particularly heavy, there is a correspondingly heavier legal liability . . . ." H.R. Rep. No. 85, 73d Cong., 1st Sess. 9 (1933).

This especial regard for registration statements is distinct from Congress' overall interest in ridding the federal securities markets of fraud. Fraud is never a virtue, and fraudfeasors deserve no special judicial solicitude. The fraudulent devices outlawed in section 10(b) "serve no legitimate function." S. Rep. No. 792, 73d Cong., 2d Sess. 7 (1934). The sweeping language of section 10(b) manifests an intent to protect investors from fraud, regardless of method, perpetrator, or market.[17] The scant attention devoted to that section in the legislative history proves the universal recognition that any form of fraud destroys confidence in the integrity of the securities markets.[18] Thus, given the existence of a private cause of action under section 10(b), it would be unreasonable – and Congress would not have intended – to disallow it simply because the fraudulent conduct is actionable under an express provision satisfied by a lesser standard of culpability.

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unfair. When defendants act with negligence, it is reasonable to limit their liability. When defendants commit fraud, it is not unjust that their damages fully compensate their victims.

[17] *See* section 20(a), 15 U.S.C. § 78t(a) (holding controlling persons jointly and severally liable for any violation of the 1934 Act or of any rule or regulation thereunder).

[18] *Cf.* Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967) (recounting the promulgation of Rule 10b-5, Milton Freeman quotes Commissioner Pike as saying "[w]ell, we are against fraud, aren't we?").

Although section 10(b) and section 11 embrace fundamentally different causes of action,[19] there are circumstances – not present in this case – in which the implied remedies of the one completely overlap the express remedies of the other. However, instances in which conduct gives rise to liability under more than one remedial provision of the federal securities acts are common and have never troubled the Supreme Court. In some cases a purchaser of securities pursuant to a registration statement may have express remedies under both sections 11 and 12(2) of the 1933 Act, 15 U.S.C. § 77*l*(2). The remedies of section 12(2) of the 1933 Act and section 9(a)(4) of the 1934 Act, 15 U.S.C. § 78i(a)(4), may also overlap. Indeed, the Court has recognized that an implied remedy under section 10(b) may duplicate a remedy under section 14 of the Securities Exchange Act, 15 U.S.C. § 78n: "that there may well be some overlap is neither unusual nor unfortunate." *National Securities, Inc., supra,* 393 U.S. at 468.

What has concerned the courts is whether an implied remedy will "nullify the effectiveness of the carefully drawn procedural restrictions on the[] express actions." *Hochfelder, supra,* 425 U.S. at 210 (footnote omitted). The first court to reject the exclusivity of the section 11 remedy in connection with the purchase of registered securities, and the one upon which subsequent courts have relied – the Second Circuit in *Fischman, supra* – was also among the first to "warn[] that Rule 10b-5 should not be construed to supersede the special statutory schemes which Congress has devised . . . ." *National Securities, Inc., supra,* 393 U.S. at 470 (Harlan, J., dissenting).

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[19] *Cf. Santa Fe Industries, supra,* 430 U.S. at 473-75 (refusing to hold that breach of fiduciary duty satisfies "fraud" requirement of section 10(b)).

Fischman upheld the section 10(b) remedy even when an express remedy is available on two grounds. First, with a scienter requirement, section 10(b) does not nullify section 11. *See Hochfelder, supra,* 425 U.S. at 210-11 (citing *Fischman* for proposition that the absence of a section 10(b) scienter requirement would nullify section 11). Second, an alternative rule would lead to "untenable" consequences. 188 F.2d at 787. Thirty years later those reasons are still compelling.

Contrary to the assertion of Herman & MacLean, Brief at 26-27, section 11 will not be nullified by permitting the section 10(b) implied remedy. There can never be nullification so long as the elements for proving the implied cause of action are different from the elements for proving the express cause of action. The rigorous procedural safeguards surrounding section 11 are necessary because substantial liability arises with mere negligence. By contrast, the strict scienter requirement of section 10(b) eliminates the need for comparable restrictions. As this Court recognized in *Hochfelder,* allowing negligence to satisfy section 10(b) would create section 11-type liability without section 11 procedural safeguards. 425 U.S. at 210-11. Thus, it is tautologically true that if, as *Hochfelder* held, nullification is avoided by proof of scienter, then no nullification exists when scienter is proved.

Consideration of the reasonableness and consequences of the decision Herman & MacLean favors is wholly absent from its Brief. Indeed, it fails to articulate the precise rule of law it would apply. On the one hand, a section 10(b) remedy could be denied whenever plaintiffs have an express remedy under section 11. This relatively narrow holding appears to be the one Herman & MacLean seeks in the question it presents to the Court. On the other hand, a

section 10(b) remedy could be denied "for registered offerings of securities," Brief of Herman & MacLean at 37, regardless of whether purchasers have any express remedy under section 11. As the lower courts have recognized almost without dissent, *see* pp. 33-34, *infra*, neither rule makes sense.[20] *See Huddleston, supra,* 640 F.2d at 542-43; *Wachovia Bank and Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342, 357 (D.C. Cir. 1980), *cert. denied,* 452 U.S. 954 (1981); *Ross, supra,* 607 F.2d at 556; *Ellis v. Carter,* 291 F.2d 270, 273 (9th Cir. 1961); *Fischman, supra,* 188 F.2d at 787.

A rule allowing a purchaser of registered securities to maintain an implied cause of action under section 10(b) only when he has no remedy under section 11 would require the courts and parties initially to litigate whether the purchaser has a section 11 remedy, a wasteful, complex, and potentially lengthy enterprise unrelated to the un-

[20]The Securities Industry Association argues that if an implied remedy under section 10(b) is permitted, "it must be subject to restrictions expressly imposed by Congress." Brief at 25. This seemingly straightforward solution is neither fair nor workable. First, if all the procedural restrictions of section 11 were appended to section 10(b), section 10(b) would become a section 11 action with the added requirements of scienter, reliance, and loss causation. Second, the procedural restrictions of section 11, necessitated by that provision's imposition of liability for negligence, are inappropriate to a remedy predicated on fraud. Third, if a purchaser of securities sued under section 10(b) for conduct also actionable under both sections 11 and 12(2), it would be unclear from which express remedy to import the procedural restrictions. Fourth, because overlapping remedies inhere in the federal securities acts, it no more follows that section 10(b) should be encumbered by the procedural restrictions of section 11, than that section 12(2) should be similarly encumbered.

derlying merits of the claim.[21] A related procedural difficulty is that the courts would have to determine which party in a section 10(b) action has the burden of proving that the plaintiff does or does not have a section 11 remedy.

The broader rule that Herman & MacLean appears to seek – that section 10(b) is unavailable to anyone purchasing registered securities, regardless of whether he has a section 11 remedy – is no more reasonable and substantially less fair. While having the advantage of clarity, such a rule would deny a federal remedy altogether for some purchasers of registered securities, like plaintiffs in this case.[22] For example, if a registration statement were

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[21]For example, if there were a dispute over whether a portion of a registration statement had been expertised by an accountant, as in the case at bar, the parties would have to litigate that issue before reaching the merits. A more complicated problem would be presented if deceitful statements were made both in SEC filings and in unfiled documents. If an investor's section 10(b) suit foundered on his inability to prove reliance, he could relitigate his claim – because a section 10(b) remedy was not available to him – under section 11 where reliance is presumed. *Cf.* Foremost Insurance Co. v. Richardson, 50 U.S.L.W. 4778, 4780 (U.S. June 23, 1982) (No. 80-2134) (declining to make admiralty jurisdiction depend upon criterion of "commercial maritime activity").

[22]Herman & MacLean suggests that defrauded purchasers who have no section 11 remedy may resort to state law. Brief at 28. To be sure, Congress chose not to preempt state blue sky remedies. Section 16 of the Securities Act of 1933, 15 U.S.C. § 77p; section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a). However, transactions in securities "are affected with a national public interest . . . ." Section 2 of the Securities Exchange Act of 1934, 15 U.S.C. § 78b. Relegating investors to their state law remedies – if any exist – is inconsistent with Congress' concern to "protect interstate commerce" and to "insure the maintenance of fair and honest markets" through a comprehensive regulatory regime. *Id.*

accurate but the issue were promoted through fraudulent press releases, a purchaser would have no remedy at all. Or, as in this case, if a fraudulent scheme were implemented by experts, an investor would have no recourse against them. *See Wachovia Bank, supra,* 650 F.2d at 357-58. To make the availability of a fraud remedy depend upon the instrument of fraud furthers no conceivable goal of the federal securities acts. Over time, such a rule would invite corporate managers to fashion their frauds in order to insulate themselves from section 11 liability, and thus from any liability whatsoever. *Fischman, supra,* 188 F.2d at 787; *see Huddleston, supra,* 640 F.2d at 542; *Wachovia Bank, supra,* 650 F.2d at 357; *Ross, supra,* 607 F.2d at 556.

C. This Court Should Confirm The Rule Of Law Overwhelmingly Adopted By The Lower Federal Courts And Implicitly Approved By Congress.

In defining the elements of the private section 10(b) suit — indeed, in affirming its existence — the Supreme Court has been guided by the experience of the lower federal courts.[23] When the Court found the implied remedy "well established" in *Superintendent, supra,* 404 U.S. at 13 n.9,

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[23]Peat, Marwick, Mitchell & Co. takes to task the federal judiciary for the common law development of actions under section 10(b). It argues that "[h]istory has shown . . . that an 'implied' § 10(b) cause of action is an inefficient substitute for the express causes of action." Brief at 7. And because the federal courts have been unable or unwilling to "develop any consensus concerning its application no legitimate remedial purpose has been furthered by judicial 'implication' of a private cause of action under § 10(b)." *Id.* at 8.

Although judicial lawmaking competence is not directly relevant to the issue presented by this case, the suggestion that "common law" adjudication is less efficient and more ambiguous than adjudication of detailed legislative enactments cannot go unchallenged. When the federal courts interpret the Constitution, their adjudicatory method is

it was simply "acquiesc[ing] in the 25-year-old acceptance by the lower federal courts. . . ." *Touche Ross, supra,* 442 U.S. at 577 n.19. Similarly, when the Court held in *Blue Chip Stamps* that section 10(b) is restricted to purchasers and sellers, it adopted the rule of law first enunciated by the Court of Appeals for the Second Circuit over twenty years earlier in *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d. Cir. 1952). Although the Supreme Court found support for its decision in the language of section 10(b), the legislative history, and considerations of policy, the centerpiece of *Blue Chip Stamps* is an exposition of the weight of lower court precedent:

> Just as this Court had no occasion to consider the validity of the *Kardon* holding that there was a private cause of action under Rule 10b-5 until 20-odd years later, nearly the same period of time has gone by between the *Birnbaum* decision and our consideration of the case now before us. As with *Kardon,* virtually all lower federal courts

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that of the common law courts. Without detailed codifications of legislative guidance, the federal courts have given content on a case-by-case basis to the written phrases, as well as the "great silences," of the Constitution. H.P. Hood & Sons v. Du Mond, 336 U.S. 525, 535 (1949) (Jackson, J.). Even in matters over which Congress has plenary authority, it has often chosen to enact legislation announcing only broad principles, leaving to the courts the job of developing the law. *See, e.g.,* the Sherman Act, 15 U.S.C. §§ 1-7; P. Areeda, *Antitrust Analysis* 4 (1967) ("Sherman Act may be little more than a legislative command that the judiciary develop a common law of antitrust"); *cf. Curran, supra,* 102 S. Ct. at 1847-48 (federal courts must "fill in the interstices" of implied causes of action). Whether Congress chooses to proceed through enactment of detailed legislation or broad principle is a matter for its decision. Nothing inheres in either method to make one more efficient, fairer, or "better" than the other. *See generally* H. Hart & A. Sacks, *The Legal Process* 138-41, 787-97 (Tent. Ed. 1958) (comparing the relative merits of common law adjudication and codification).

> facing the issue in the hundreds of reported cases presenting this question over the past quarter century have reaffirmed *Birnbaum's* conclusion. . . .

421 U.S. at 731.

As in *Blue Chip Stamps,* the question presented in this case is not a novel one for the federal courts. The rule affirmed by the Court below followed the 1951 decision of the Second Circuit in *Fischman v. Raytheon Manufacturing Co., supra.*[24] In the thirty-one years since *Fischman* was decided, every federal court, with one exception,[25] has adopted its holding either expressly[26] or implicitly,[27] in

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[24]The opinion was written by Judge Frank, an early member of the SEC. *Cf. Blue Chip Stamps, supra,* 421 U.S. at 731 ("The panel which decided *Birnbaum* consisted of Chief Judge Swan, and Judges Learned Hand and Augustus Hand: the opinion was written by the last named").

[25]Berger v. Bishop Investment Corp., 528 F. Supp. 346 (E.D. Mo. 1981), *appeal filed,* No. 81-2435 (8th Cir. Dec. 28, 1981).

[26]*Wachovia Bank, supra*; Wolf v. Frank, 477 F.2d 467 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973); Jordan Building Corp. v. Doyle, O'Connor & Co., 401 F.2d 47 (7th Cir. 1968); *Ellis, supra;* Matheson v. Armbrust, 284 F.2d 670 (9th Cir. 1960), *cert. denied,* 365 U.S. 870 (1961); Gilbert v. Nixon, 429 F.2d 348 (10th Cir. 1970); Stewart v. Bennett, 359 F. Supp. 878 (D. Mass. 1973); Roth v. Bank of the Commonwealth, Fed. Sec. L. Rep. (CCH) ¶ 98,267 (W.D.N.Y. 1981); In re New York City Municipal Securities Litigation, 507 F. Supp. 169 (S.D.N.Y. 1980); Tirone v. Calderone-Curran Ranches, Inc., Fed. Sec. L. Rep. (CCH) ¶ 96,480 (W.D.N.Y. 1978); Beecher v. Able, 435 F. Supp. 397 (S.D.N.Y. 1977); Morse v. Peat, Marwick, Mitchell & Co., Fed. Sec. L. Rep. (CCH) ¶ 95,492 (S.D.N.Y. 1976); Wolfson v. Solomon, 54 F.R.D. 584 (S.D.N.Y. 1972); Rosen v. Bergman, 40 F.R.D. 19 (S.D.N.Y. 1966); Weber v. C.M.P. Corp., 242 F. Supp. 321 (S.D.N.Y. 1965); Thiele v. Shields, 131 F. Supp. 416 (S.D.N.Y. 1955); Dauphin Corp. v. Redwall Corp., 201 F. Supp. 466 (D. Del. 1962); Premier Industries, Inc. v. Delaware Valley Financial Corp., 185 F. Supp. 694 (E.D. Pa. 1960); Pearlstein v. Justice Mortgage Investors, Fed. Sec. L. Rep. (CCH) ¶ 96,760 (N.D. Tex. 1978); Woods v. Homes & Structures of Pittsburg, Kansas, Inc., 489 F. Supp. 1270

refusing to deny a section 10(b) claim because a concurrent remedy exists under the 1933 Act. As in *Blue Chip Stamps*, this Court should endorse the rule of "longstanding acceptance" that the lower federal courts, after careful analysis of the problem, have found best reconciles the implied remedy of section 10(b) with the express remedies of the federal securities acts.

Approval of the reconciliation fashioned by *Fischman* is particularly apt since Congress has accepted it. Because Congress is presumed to "know the law," *Cannon, supra,*

(D. Kan. 1980); In re Clinton Oil Co. Securities Litigation, Fed. Sec. L. Rep. (CCH) ¶ 96,015 (D. Kan. 1977); Trussell v. United Underwriters, Ltd., 228 F. Supp. 757 (D. Colo. 1964); *McFarland, supra;* Orn v. Eastman Dillon, Union Securities & Co., 364 F. Supp. 352 (C.D. Cal. 1973); Demoe v. Dean Witter & Co., 476 F. Supp. 275 (D. Alaska 1979).

Other courts have upheld a section 10(b) remedy where other remedies exist under the 1934 Act. *E.g., Ross, supra*; Dann v. Studebaker-Packard Corp., 288 F. 2d 201 (6th Cir. 1961); Schaefer v. First National Bank of Lincolnwood, 509 F.2d 1287 (7th Cir. 1975), *cert. denied,* 425 U.S. 943 (1976); Cowin v. Bresler, Fed. Sec. L. Rep. (CCH) ¶ 98,393 (D.D.C. 1981); Stromfeld v. Great Atlantic & Pacific Tea Co., 484 F. Supp. 1264 (S.D.N.Y. 1980); In re Investors Funding Corp. of New York Securities Litigation, 523 F. Supp. 550 (S.D.N.Y. 1980); Abrams v. Johns-Manville Corp., Fed. Sec. L. Rep. (CCH) ¶ 98,348 (S.D.N.Y. 1981); Wolgin v. Magic Marker Corp., 82 F.R.D. 168 (E.D. Pa. 1979); Issen v. GSC Enterprises, Inc., 522 F. Supp. 390 (N.D. Ill. 1981); Steele v. Allison, Fed. Sec. L. Rep. (CCH) ¶ 98,459 (N.D. Cal. 1982).

[27] *E.g.,* Globus v. Law Research Service, Inc., 418 F.2d 1276 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970); Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), *cert. denied,* 395 U.S. 977 (1969); McClure v. Borne Chemical Co., 292 F.2d 824 (3d Cir. 1961); Fox v. Kane-Miller Corp., 398 F. Supp. 609 (D. Md. 1975), *aff'd,* 542 F.2d 915 (4th Cir. 1976); Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir.), *cert. denied,* 400 U.S. 852 (1970); In re Equity Funding Corp. of America Securities Litigation, 416 F. Supp. 161 (C.D. Cal. 1976), *aff'd,* 603 F.2d 1353 (9th Cir. 1979).

441 U.S. at 697, its failure to change a clear and uniform rule is persuasive evidence that it approves the rule. Last Term in *Curran, supra,* the Court upheld an implied action under the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, on the ground that Congress' failure to take away the established private action when the Act was amended in 1974 created a compelling "inference that [it] intended to preserve the preexisting remedy. . . ." 102 S. Ct. at 1843.

A like inference is even more compelling in this case. On three occasions in the thirty years since *Fischman* was decided, Congress has undertaken substantial reviews of the federal securities acts during which it evinced an awareness of the private remedy under section 10(b).

First, as this Court has recounted, Congress considered several bills in 1957 and 1959 that, *inter alia,* would have amended section 10(b). *Blue Chip Stamps, supra,* 421 U.S. at 732. *See* Hearings on S. 1178-1182 before a Subcommittee of the Senate Committee on Banking & Currency, 86th Cong., 1st Sess. 367-68 (1959).

Second, at the direction of Congress in 1961, the SEC conducted an extensive study on the adequacy of federal securities legislation. In discussing the various remedies for fraud, the study observed that "[a]lthough section 10(b) and the rule [10b-5] merely state that the conduct is 'unlawful,' the courts have almost uniformly held that they create a private right of action." Report of Special Study of Securities Markets of the Securities and Exchange Commission, Part 3, H.R. Doc. No. 95, 88th Cong., 1st Sess. 96 (1963) (footnote omitted). Relying upon the recommendations contained in this report, Congress passed the Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565.

Third, in 1975 Congress added section 21(g) to the Securities Exchange Act of 1934, 15 U.S.C. § 78u(g), which bars the consolidation of private causes of action with SEC injunctive proceedings. Securities Acts Amendments of 1975, § 17, Pub. L. No. 94-29, 89 Stat. 155. All cases cited in the Committee Report as examples where consolidation had hindered the prompt disposition of SEC enforcement actions involved a private damage suit under section 10(b). *See* S. Rep. No. 94-75, 94th Cong., 2d Sess. 251 (1975), *reprinted in* 1975 *U.S. Code Cong. & Ad. News* 179, 253.

Although these legislative reports contain no express reference to *Fischman,* its prominence makes the rule of that case "part of the 'contemporary legal context' in which Congress legislated. . . . "[28] *Curran, supra,* 102 S.

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[28]Herman & MacLean asserts that in *Curran* this Court cast doubt upon whether Congress has acquiesced in the existence of the implied section 10(b) remedy. Brief at 29-30. It relies upon a footnote stating that "no comparable legislative approval or acquiescence exists for the Rule 10b-5 remedy" as for the implied remedy under the Commodity Exchange Act. 102 S. Ct. at 1845 n.88. Herman & MacLean misses the import of that note, which points out only the unique development and acceptance of section 10(b). That the Court did not intend to disparage Congress' complete acquiescence in the section 10(b) remedy is demonstrated by its lengthy citation from *Piper, supra,* four footnotes later:

> The statutes originally enacted in 1933 and 1934 have been amended so often with full congressional awareness of the judicial interpretation of Rule 10b-5 as implicitly creating a private remedy that we must now assume that Congress intended to create rights for the specific beneficiaries of the legislation as well as duties to be policed by the SEC. This case therefore does not present the same kind of issue discussed in *Cort v. Ash,* 422 U.S. 66 (1975), namely, *whether* the statute created an implied private remedy. Rather, the question presented here is *who* may invoke that remedy. *Piper v. Chris-Craft Industries,* 430

Ct. at 1841) (quoting *Cannon, supra,* 441 U.S. at 699). The consensus of courts and Congress in accepting the *Fischman* rule argues persuasively for its endorsement by this Court.

II. No. 81-1076

SUMMARY OF ARGUMENT

The Court of Appeals held that the clear and convincing, rather than the preponderance, standard is required to prove each element of a section 10(b) case. None of the justifications for its decision merits use of the higher standard.

A standard of proof represents society's judgment of which party should bear the risk of an erroneous decision. Under the preponderance standard, the parties equally share that risk. A more stringent standard of proof favors the defendant and increases the likelihood of an erroneous decision. In section 10(b) cases, there is no reason to favor the defendant at the expense of the plaintiff. Neither the opprobrium that attaches to a fraudfeasor nor his liability for damages is an important interest of the type that this Court has protected through the clear and convincing standard. Many important civil cases, both constitutional and statutory, are decided under the preponderance standard.

That a section 10(b) suit involves proof of scienter does not require the clear and convincing standard. This Court and lower courts have employed the preponderance standard in cases brought under the antifraud provisions of the federal securities acts. Nor does reliance on circumstantial

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U.S. 1, 55 n.4 (Stevens, J., dissenting) (emphasis in original).

102 S. Ct. at 1846 n.92.

evidence to prove scienter mandate a higher standard of proof. Such evidence is commonplace in civil litigation and may be more persuasive than direct evidence.

Use of the clear and convincing standard in private section 10(b) suits would be anomalous in light of *Steadman v. SEC,* 450 U.S. 91 (1981), which required only the preponderance standard in SEC administrative proceedings where a defendant's livelihood, not merely damages, is at stake. The lower standard also applies in SEC injunctive actions. If private and SEC injunctive suits are tried under different standards of proof, the doctrine of collateral estoppel cannot be used to avoid the relitigation of issues. This Court should adopt the preponderance of the evidence standard in section 10(b) cases.

ARGUMENT

The function of a standard of proof is to "instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication." *In re Winship,* 397 U.S. 358, 370 (1970) (Harlan, J., concurring). *See Addington v. Texas,* 441 U.S. 418, 423 (1979); *see generally,* J. Wigmore, *Evidence* §§ 2485-86 (3d. Ed. 1940). Since liberty is at risk in a criminal proceeding, the factfinder must believe beyond reasonable doubt in the correctness of his decision. This is because society prefers to "impose[] almost the entire risk of error upon itself." *Addington, supra,* 441 U.S. at 424. In certain civil proceedings where the defendant's personal freedoms or other important rights are jeopardized, the Supreme Court has adopted an intermediate standard of proof: the clear and convincing standard. *E.g., Santosky v. Kramer,* 102 S. Ct. 1388 (1982) (termination of parental rights); *Addington, supra* (involuntary commitment); *Woodby v. INS,* 385 U.S. 276

(1966) (deportation). In the normal civil proceeding, in which neither party has a more important interest at stake than the other, the preponderance standard applies.

Raising the standard of proof involves a cost. As the standard rises, so does the overall risk of an erroneous judgment. Thus "[a]doption of any standard more stringent than the 'preponderance of the evidence' necessarily expresses either a preference for one of the parties or a desire to handicap the other." Comment, "Scope of Review of Standard of Proof – Judicial Control of SEC Sanctions," 93 Harv. L. Rev. 1845, 1852 (1980) (footnote omitted). *See Addington, supra,* 441 U.S. at 428 (heavy burden in criminal cases manifests a concern that the "risk of error to the individual must be minimized even at the risk that some who are guilty might go free"). In most civil cases, society has no interest in preferring one party or handicapping the other. Its interest is in maximizing the likelihood of a correct judgment. *Santosky, supra,* 102 S. Ct. at 1395; *Addington, supra,* 441 U.S. at 423.

In this case, the Court of Appeals relied on four grounds in holding that the plaintiff must prove his section 10(b) claim by clear and convincing evidence.[29] First, a judgment of fraud injures a defendant's reputation more than other adverse civil judgments. Second, the "higher threshold of proof of fraud required in Rule 10b-5 actions mandates. . . the higher burden of proof." Third, proof of intent to deceive is "often a matter of inference. . . ." Fourth, the clear and convincing standard is the traditional burden in civil fraud cases. App. A-17 & n.19, No. 81-680. None of these arguments warrants a departure

[29] *See* McBaine, *Burden of Proof: Degrees of Belief,* 32 Calif. L. Rev. 242, 261-63 (1944) (defining preponderance of evidence and clear and convincing standards of proof).

from the preponderance standard traditionally applied in civil disputes between private parties. *Addington, supra,* 441 U.S. at 423; *see Santosky, supra,* 102 S. Ct. at 1398.

First, the possible opprobrium to a defendant that may result from an adverse private section 10(b) decision clearly falls far short of the constitutional rights or other extraordinary interests – termination of parental rights, involuntary commitment – that warrant the clear and convincing standard of proof. Indeed, if the risk of expatriation does not compel clear and convincing proof, *Vance v. Terrazas,* 444 U.S. 252 (1980), neither does the risk to reputation of a section 10(b) defendant. Many cases of great national moment, both constitutional and statutory, are decided under the lower standard. In any event, the stigma of a private section 10(b) judgment is far less than that attending sanctions imposed under an SEC disciplinary proceeding, where the preponderance standard governs. *Steadman, supra.*

To apply a more stringent standard than the preponderance of evidence is to favor the fraudfeasor at the expense of the defrauded and to increase the likelihood that defrauded purchasers will go uncompensated. The risk of economic loss does not justify such solicitude for the defendant. As this Court has observed, "while private parties may be interested intensely in a civil dispute over money damages, application of a 'preponderance of the evidence' standard indicates both society's 'minimal concern with the outcome,' and a conclusion that the litigants should 'share the risk of error in roughly equal fashion.' " *Santosky, supra,* 102 S. Ct. at 1395 (quoting *Addington, supra,* 441 U.S. at 423). Herman & MacLean's interest in avoiding an erroneous damage judgment is no greater than the interest of defrauded investors in receiving compensation for their injuries.

Contrary to the Court of Appeals opinion, the clear and convincing standard is not mandated because a section 10(b) suit requires proof of scienter. This argument constitutes a non sequitur. How persuaded of the facts the jury must be has no relevance to what facts, as a matter of law, it must find. In one of its earliest decisions under the federal securities laws, *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 355 (1943), this Court applied the preponderance standard to a fraud case brought under section 17(a) of the Securities Act of 1933. Similarly, other courts of appeals have adopted the preponderance standard in section 10(b) cases and other actions under the federal securities laws,[30] and it has been adopted and upheld as the standard section 10(b) jury instruction.[31]

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[30] *E.g.*, Mihara v. Dean Witter & Co., 619 F.2d 814, 824-25 (9th Cir. 1980) (preponderance standard approved in churning case brought under section 10(b)); SEC v. First Financial Group of Texas, 645 F.2d 429, 434-35 (5th Cir. 1981) (preponderance standard applied to SEC civil enforcement proceedings); SEC v. Savoy Industries, Inc., 587 F.2d 1149, 1169 (D.C. Cir. 1978) (same), *cert. denied*, 440 U.S. 913 (1979); Miley v. Oppenheimer & Co., 637 F.2d 318, 328 (5th Cir. 1981) (preponderance standard in churning case); Dzenits v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 494 F.2d 168, 171 n.2 (10th Cir. 1974) (same); G.A.F. Corp. v. Milstein, 453 F.2d 709, 718 (2d Cir. 1971) (plaintiff in injunctive action under section 13(d) of the Securities Exchange Act of 1934 given opportunity to prove case by "fair preponderance of the evidence"), *cert. denied*, 406 U.S. 910 (1972); *Globus, supra* (causation in section 10(b) action properly shown "by a fair preponderance of the evidence"); University Hill Foundation v. Goldman, Sachs & Co., 422 F. Supp. 879 (S.D.N.Y. 1976) (plaintiffs did not prove their case under section 12(2) and section 10(b) "by a preponderance of the evidence"); Franklin Life Insurance Co. v. Commonwealth Edison Co., 451 F. Supp. 602 (S.D. Ill. 1978) (preponderance of evidence in section 10(b) suit), *aff'd per curiam*, 598 F.2d 1109 (7th Cir.), *cert. denied*, 444 U.S. 900 (1979).

[31] *See* DeVitt & Blackmar, *Federal Jury Practice and Instructions* §§ 98.04, 98.12, 98.13 (3d Ed. 1977) (preponderance standard applies to jury's findings in Rule 10b-5 actions), *upheld in Mihara, supra*, 619 F.2d at 824-25.

That scienter must often be proved through inferential or circumstantial evidence does not compel use of the clear and convincing standard. Inferential evidence is no less reliable than direct evidence. Indeed, this Court has recognized that indirect, "[c]ircumstantial evidence is not only sufficient, but may also be more certain, satisfying and persuasive than direct evidence." *Michalic v. Cleveland Tankers, Inc.*, 364 U.S. 325, 330 (1960); *see also Terrazas, supra,* 444 U.S. at 260; *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 463 & n.24 (1976); *C.M. Joiner, supra,* 320 U.S. at 355. Moreover, the deceptive nature of schemes to defraud often defeats direct proof of intent. Plaintiffs should not be penalized with a higher standard of proof because a defendant successfully conceals the details of his deception.

The Court of Appeals' judgment to apply the clear and convincing standard is anomalous in light of *Steadman, supra,* which held that the preponderance of evidence standard applies in SEC disciplinary proceedings brought under section 10(b). The lower standard applies as well in SEC injunctive actions. *See First Financial Group of Texas, supra; Savoy Industries, supra.* Because the standard of proof, by hypothesis, is a choice dictated by the nature of the defendant's interests, the identity of the plaintiff should have no bearing on that choice. The preponderance standard adjudged sufficient to protect the defendant's interests in an SEC proceeding is no less sufficient to protect his interests in suits brought by private parties.

Moreover, different standards of proof in private suits and agency actions hinder the orderly and efficient disposition of securities litigation by foreclosing use of the doctrine of collateral estoppel. In *Parklane Hosiery Co. v. Shore,* 439 U.S. 322 (1979), this Court held that a private

plaintiff could collaterally estop a defendant from relitigating issues previously decided in an action brought by the SEC. Whether used offensively by a plaintiff or defensively by a defendant, collateral estoppel "protect[s] litigants from the burden of relitigating an identical issue. . . and promot[es] judicial economy by preventing needless litigation." *Id.* at 326. However, collateral estoppel may be used only if the standard of proof in the first proceeding is as stringent as the standard in the subsequent proceeding. If private and SEC injunctive suits are tried under different standards of proof, the benefits of collateral estoppel would be squandered.

Considerations of policy thus clearly favor the preponderance of evidence standard.[32] Neither the interests of the defendant, nor the interests of society in assuring accurate judgments warrant the clear and convincing standard in section 10(b) cases.

[32]State law provides little assistance in deciding this question. By the count of Herman & MacLean, a bare majority of states continues to require the clear and convincing standard in common law fraud actions. Brief at 45-46; *see id.* at CA-1-CA-18. The remainder have adopted some lesser standard, with twelve states settling on the preponderance of evidence. The absence of any consensus among the states on this issue undermines the persuasive value that a uniform state rule might otherwise have upon the resolution of a federal question.

CONCLUSION

The Court should affirm the holding of the Court of Appeals that plaintiffs are entitled to sue under section 10(b) of the 1934 Act, and reverse the Court of Appeals' holding that the clear and convincing standard is appropriate in section 10(b) cases.

Respectfully submitted,

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No. 81-680

IN THE

Supreme Court of the United States

OCTOBER TERM 1982

(No. 81-680)
HERMAN & MACLEAN,

Petitioner,

v.

RALPH E. HUDDLESTON AND CHESTER E. BRADLEY,
individually and as class representatives,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF OF HERMAN & MacLEAN

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October 29, 1982

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ARGUMENT SUMMARY

Plaintiffs argue that they should have recourse to § 10(b) of the Securities Exchange Act of 1934 because of alleged falsity in a registration statement filed in accordance with the requirements of the Securities Act of 1933. They argue that § 11 of the Securities Act of 1933 does not provide the exclusive federal remedy for purchasers of registered securities, notwithstanding its undoubted comprehensiveness, because the federal courts can, by a judicious balancing of increased burdens to the claimants and reduced defenses to the defendants, fashion alternative remedies which do not nullify the statutory remedy provided by Congress. In particular, plaintiffs argue that § 11 requires only a showing of negligence and that its provisions are therefore not nullified by permitting securities purchasers also to sue under § 10(b), which requires proof of scienter. Plaintiffs Brief at 11.

As stated by Judge Rubin below, this analysis, first announced in *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951), provides the "classic reconciliation of the apparent overlap of the express civil liability provisions of the 1933 Act and the cause of action implied in Rule 10b-5." Pet. App. A-7. The plaintiffs and the Securities and Exchange Commission argue that the Court in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) has endorsed the *Fischman* analysis. Plaintiffs contend that when the Court in *Hochfelder* refused to permit recovery under § 10(b) on the basis of negligent conduct because to do so would "nullify the effectiveness of the carefully drawn procedural restrictions on [actions brought under § 11, § 12(2), or § 15 of the 1933 Act]," 425 U.S. at 210, it then became "tautalogically true" that nullification of § 11 is avoided whenever scienter is required to be proved in an action brought under

§ 10(b). Plaintiffs Brief at 28. The Commission argues that the Court's reasoning in *Hochfelder* forecloses altogether the issue of whether § 11 preempts the bringing of suit under § 10(b). Commission Brief at 12.

The nullification argument does indeed lie at the heart of the issue here presented.[1] The *Fischman* analysis does not, however, provide a justification for an implied remedy on behalf of purchasers of registered securities, for two reasons. First, the argument, when applied to the remedies available under § 11, presupposes a statutory scheme that does not exist. It assumes incorrectly that § 11 provides for liability based only on negligent conduct. Secondly, the argument presumes that even when Congress has clearly,

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[1]On August 16, 1982, the Fifth Circuit in *Chemetron Corp.* v. *Business Funds, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 98,777, refused to permit recovery under § 10(b) to plaintiffs who had also alleged but failed to prove an express cause of action under § 9 of the 1934 Act. The holding in *Chemetron* is important for two reasons: first, it emphasizes the view of the lower courts that implied remedies may be asserted in addition to express remedies when, but only when, *Fischman's* nullification test is satisfied. Secondly, because the court did not hold that cumulative remedies are always available under the federal securities laws, the *Chemetron* decision calls into question the sweeping *stare decisis* and legislative reenactment arguments of the plaintiffs and the Commission. These arguments are also weakened by the misstatement by both the plaintiffs and the Commission of the holding of *Gilbert* v. *Nixon*, 429 F.2d 348 (10th Cir. 1970). Plaintiffs Brief at 33 n. 26; Commission Brief at 13 n. 7. In *Gilbert* the court held that where a conflict exists between the explicit provisions of the statutory remedy granted by § 12(2) of the Securities Act of 1933 and the remedy implied from § 10(b), the conflict should be resolved in favor of the express remedy. *Id.* at 355. As the plaintiffs recognize, Plaintiffs Brief at 29 n. 20, the effect of the *Gilbert* holding is to limit purchasers in registered offerings to actions brought under § 11.

directly, and comprehensively addressed in § 11 the issue of liability for registered offerings, the federal courts are free to alter or supplement that statutory scheme to conform to a perceived overriding federal policy. Both of these assumptions are demonstrably untrue.

Section 11 contains a comprehensive scheme for assessing liability for false and misleading statements and varies the degree of culpability necessary for liability to fit the circumstances of the particular defendant.[2] It also precludes liability for certain participants in the registration process, whatever their culpability may have been, and limits the basis for the imposition of liability as to other participants to those matters for which such participants are identified as having been responsible.

Because Congress by enacting § 11 provided a comprehensive remedy to defrauded purchasers of registered securities, the federal common law created by the courts around § 10(b) and rule 10b-5 must give way on those matters addressed by Congress. The courts are not free to substitute their judgments for the direct mandate of the statute.

The plaintiffs and the Commission argue that the "legislative reenactment" doctrine as applied in the recent *Curran* opinion supports the implication of a § 10(b) remedy in favor of plaintiffs. They would employ that doctrine, however, as a vehicle for determining not only whether a cause of action may be implied under § 10(b)

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[2]The legislative history of the 1933 Act elucidates the obvious:

> The duty of care to discover varies in its demands upon participants in security distribution with the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 9 (1933).

but also to determine those cases in which a cause of action may be invoked. To employ that doctrine as the Commission and plaintiffs suggest would convert it into a doctrine of repeal by implication. The Commission and plaintiffs also overlook the differences in the nature of the "reenactment" upon which the decision in *Curran* was based and the post-enactment history of the federal securities laws. They have also overlooked the only post-enactment statements by Congress addressed to the instant question, which confirm that § 11 of the 1933 Act was intended to provide the exclusive federal civil remedy in the circumstances to which it is addressed.

Finally, despite plaintiffs' and the Commissions' contentions to the contrary (Plaintiffs Brief at 4 n. 6; Commission Brief at 6 n. 1), the Court should consider whether purchasers of registered securities may sue under § 17(a) of the 1933 Act. The court below did not address the issue because it upheld the right of plaintiffs to sue under § 10(b). If this Court holds that plaintiffs may not sue under § 10(b), then the availability of § 17(a) must be considered.

ARGUMENT

I. **Section 11 is more than a negligence statute.** The major premise underlying the *Fischman* principle is that § 11 is a statute directed solely to negligent conduct. This proposition was advanced by the respondents and rejected by the Court in *Hochfelder*. The respondents in *Hochfelder* argued that the remedial purposes underlying both the Securities Act of 1933 and the Securities Exchange Act of 1934 require a uniform standard of liability, that the standard of liability under the 1933 Act is a negligence standard, and that the Court should therefore construe § 10(b) as embracing a negligence standard. In rejecting

this line of argument, the Court observed that § 11 and the other express liability provisions of the federal securities laws provide for liability under a variety of differing circumstances and tailor to fit those circumstances the degree of culpability required:

> But in seeking to accomplish its broad remedial goals, Congress did not adopt uniformly a negligence standard even as to express civil remedies. In some circumstances and with respect to certain classes of defendants, Congress did create express liability predicated upon a failure to exercise reasonable care. *E.g.*, 1933 Act § 11(b)(3)(B), 48 Stat. 82, as amended, 15 U.S.C. § 77k (b)(3)(B) (liability of "experts," such as accountants for misleading statements in portions of registration statements for which they are responsible). But in other situations good faith is an absolute defense. 1934 Act § 18, 48 Stat. 897, as amended, 15 U.S.C. § 78r (misleading statements in any document filed pursuant to the 1934 Act). And in still other circumstances, Congress created express liability regardless of the defendant's fault, 1933 Act § 11(a), 15 U.S.C. § 77k(a) (issuer liability for misleading statements in the registration statement).
>
> It is thus evident that Congress fashioned standards of fault in the express civil remedies in the 1933 and 1934 Acts on a particularized basis.• • •

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185, 200 (1976).

Subparagraph (b) of § 11 considers the issue of liability by reference to negligent, reckless, and intentional behavior. Signatories to the registration statement, directors of the issuer, and underwriters are liable for nonexpertized materials in a registration statement unless they can prove both their due diligence *and* their belief that the statements contained in that part of the registration statement on

which their liability is sought to be predicated were true and did not require additional disclosure in order to make such statements not misleading. Section 11(b)(3)(A). The same standard applies in determining the liability of experts for defects in materials included in a registration statement with their consent and on the basis of their own authority as experts. Section 11(b)(3)(B).

The liability of nonexperts (other than the issuer) for expertized materials turns upon their ability to prove an absence of reckless behavior — the absence of any reasonable ground for them to believe in the untruth or materially omissive nature of such expertized materials, unaccompanied however by any correlative duty to perform an investigation — *and* their lack of an actual belief in the untruth or materially omissive nature of such expertized materials. Section 11(b)(3)(C). The issuer is, of course, liable for false and misleading registration statements irrespective of any state of mind or culpability considerations.

Most importantly for the present appeal, an expert such as Herman & MacLean may be found liable under § 11 only for defects in the materials for which such expert is identified in the registration statement as having been responsible.[3] When Congress enacted the comprehensive statutory

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[3]The only defect in the audited financial statements charged to Herman & MacLean is its failure to disclose a post-audit date borrowing by T.I.S. of $100,000 from an affiliate of the general contractor of the speedway. Although plaintiffs state that the loan materially altered the financial picture of T.I.S., Plaintiffs Brief at 6, such is manifestly not the case. The T.I.S. prospectus disclosed in its opening paragraph that the issuer was a newly-organized company attempting to raise money to build an automobile racing facility. J.A. 161a. It further disclosed that $1.3 million had been raised from previous equity financings, that $1,204,723 of financing was being provided by deferred payment

scheme represented by § 11, it chose to exclude experts from liability for nonexpertized materials and for materials expertized by other experts, consciously differentiating experts from other participants in the registration process.[4]

The significance of this distinction is demonstrated in the present case. The plaintiffs' claims stem primarily from underestimates of costs necessary to complete the construction of an automobile raceway facility. These estimates were made by the issuer, Texas International Speedway, Inc., and were included in the registration statement on the basis of the authority as experts of an engineering firm, Spencer Buchanan & Associates, Inc. J.A. 170a, 211a. No purchaser of the securities had any basis, from a reading of the prospectus, for relying upon Herman & MacLean for the accuracy of estimated costs of construction. An undertaking to estimate construction costs was outside the competence of Herman & MacLean. Under these circumstances, Congress by enacting § 11 intended that Herman & MacLean be exempt from liability. It did not intend that Herman & MacLean be required even to establish the spe-

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arrangements, and that the total costs and expenses relating to the construction of the speedway were estimated at $6,249,338. J.A. 168a, 169a. Finally, it disclosed that on the effective date of the prospectus the construction of the facility was substantially complete. J.A. 164a. Therefore, the T.I.S. prospectus fairly disclosed that post-audit date borrowings must have occurred in order to keep the construction process going. The business plan of T.I.S. may have been financially unsound, but it was fully disclosed. *Cf. Santa Fe Industries* v. *Green*, 430 U.S. 462 (1977).

[4]The intent of Congress to exclude from the ambit of § 11 certain persons and to limit the liability of others must be accorded the same respect as the intent of Congress to impose liability where it felt appropriate. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 713, 736 n. 8 (1975).

cialized defense — accomplished by showing a lack of reckless or intentional behavior — which nonexperts are required to establish in order to avoid liability for defects in expertized materials.

There is nothing in the statute or in the legislative history to indicate that Congress intended that experts, or any other participant in the registration process, be subjected to liability based on the ill-defined aider and abettor concepts with which the federal courts are today struggling in § 10(b) cases. *See e.g., Fund of Funds, Ltd.* v. *Arthur Andersen & Co.*, 545 F. Supp. 1314 (S.D.N.Y. 1982).[5]

Because § 11 is not simply a negligence statute, the *Fischman* analysis breaks down. Congress designed § 11 to cover the entire range of participants in the public offering process. Those excluded from liability, such as the attorneys for the issuer and for the underwriters and officers of the issuer who did not sign the registration statement, must be regarded by the courts as having been excluded advisedly. Similarly, those whose liabilities are limited under § 11

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[5]As is apparent even from plaintiffs characterization of the record, Plaintiff's Brief 5-6, the representations contained in the T.I.S. registration statement which are not the subject of Herman & MacLean's report could provide a basis for liability under § 10(b) only under an "aiding and abetting" theory of liability. To sanction such a remedy, however, would necessitate another level of judicial lawmaking, for there is no mention in the 1933 or 1934 Acts of an "aiding and abetting" cause of action. Indeed, when in 1959 the SEC proposed adding "aiding and abetting" provisions to the 1933 and 1934 Acts it made clear that those provisions would apply only to SEC administrative proceedings and enforcement actions and that "no civil liability is intended." *SEC Legislation: Hearings on S.1178, et al., Before a Subcom. of Sen. Comm. on Banking and Currency*, 86th Cong., 1st Sess. at 288 (1959). The Senate passed such a bill, S.3769, 3770, 86th Cong., 2d Sess. (1960), but the House never voted on it.

to defects contained in certain portions of the registration statement must be regarded by the courts as having had their liabilities limited advisedly.

In summary, since Congress has in § 11 provided defendants, including defendants alleged to have acted fraudulently,[6] grounds for avoiding or limiting their liability, the courts may not, on the basis of their own or the Commission's interpretation of social policy,[7] create a different cause of action on the theory that § 11 provides an incomplete remedy.

II. The federal common law created by the courts under § 10(b) must yield to the express provisions of § 11.

The primary defect in the *Fischman* analysis is not the incorrectness of its application to the particular circumstances of the present case, but rather is that the undertaking of the analysis misconceives the proper role of the federal courts. Before the enactment of the Securities Act

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[6]The assertion that § 11 is only a negligence statute is also refuted by the provisions of § 11(f) of the 1933 Act. Herman & MacLean Brief, SA-9. Section 11(f) provides for joint and several liability among those persons specified in § 11(a), but also provides for contribution "unless the person who has become liable was, and the other was not, guilty of *fraudulent* misrepresentation." The only distinction between fraudulent and nonfraudulent conduct found in express liability provisions of the 1933 Act is that found in § 11(f).

[7]The Commission speaks deprecatingly of "whatever remedies may be available under Section 11," Commission Brief at 4, and appears to regard as a virtue the fact that § 10(b) and rule 10b-5 are the most litigated provisions in the federal securities laws. Commission Brief at 21. Undoubtedly, because of its uncertain and amorphous nature, litigation under § 10(b) provides greater latitude than does litigation under § 11 for results based on changing views of social policy, but this consideration weighs in favor of and not against the primacy of § 11.

of 1933, there was no federal legislation generally regulating the capital formation process. The Securities Act of 1933 was designed to provide to investors full disclosure of material information concerning public offerings of securities and, as a corollary, to protect investors and to promote ethical standards of honesty and fair dealing through the imposition of specified civil liabilities. *See* H. R. Rep. No. 85, 73d Cong., 1st Sess. 1-5 (1933) and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 195 (1976). No one who has read the statute can dispute the comprehensiveness of § 11. Under these circumstances the federal courts may not alter or supplement the statutory remedy.

In a recent case, the Court has reconciled a recognized implied remedy of general application with a statutory remedy created under the Death on the High Seas Act, 46 U.S.C. § 761 et seq., and has refused to permit the statutory remedy to be "supplemented" by a judicially implied remedy. In *Mobil Oil Corp.* v. *Higginbotham,* 436 U.S. 618 (1978), the issue was whether survivors of a person killed in an accident occurring outside of territorial waters, and hence subject to the Death on the High Seas Act, could recover for "loss of society." The Death on the High Seas Act does not prohibit the payment of damages for loss of society, but specifies that the recovery to which a beneficiary shall be entitled is compensation "for the *pecuniary* loss . . . ," 46 U.S.C. § 762.

The Court had earlier held that a federal remedy for wrongful death exists under general maritime law, *Moragne* v. *States Marine Lines, Inc.,* 398 U.S. 375 (1970), and that, where death occurs in territorial waters, loss of society is an element of the damages recoverable, *Sea-Land Services, Inc.* v. *Gaudet,* 414 U.S. 573 (1974). In so holding, the Court followed the "clear majority of the States," *id.* at 587, and "the humanitarian policy of the maritime law to show 'spe-

cial solicitude' for those who are injured within its jurisdiction," *id.* at 588.

In *Higginbotham* the Court refused to extend the rule of damages applicable under general maritime law to actions covered by the Death on the High Seas Act. Writing for the majority, Justice Stevens held:

> We realize that, because Congress has never enacted a comprehensive maritime code, admiralty courts have often been called upon to supplement maritime statutes. The Death on the High Seas Act, however, announces Congress' considered judgment on such issues as the beneficiaries, the limitations period, contributory negligence, survival, and damages. * * * The Act does not address every issue of wrongful-death law, . . . but when it does speak directly to a question, the courts are not free to "supplement" Congress' answer so thoroughly that the Act becomes meaningless.
>
> * * * There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted. In the area covered by the statute, it would be no more appropriate to prescribe a different measure of damages than to prescribe a different statute of limitations, or a different class of beneficiaries. Perhaps the wisdom we possess today would enable us to do a better job . . . than Congress did in 1920, but even if that be true, we have no authority to substitute our views for those expressed by Congress in a duly enacted statute.

436 U.S. at 625-26.[8]

Just as the federal courts must give the statutory remedy provided by the Death on the High Seas Act precedence over the federal common law remedy created in *Moragne*, the federal courts must also give the statutory remedy provided by § 11 precedence over the federal common law remedies created pursuant to § 10(b). The holding in *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 102 S.Ct. 1825 (1982), is not to the contrary. There, the Court merely recognized the authority of the federal courts to formulate and define implied remedies where Congress has "left the matter at large for judicial determination," citing *Board of Comm'rs* v. *United States*, 308 U.S. 343, 351 (1939). 102 S.Ct. at 1838. The Court in *Curran* did not permit federal common law to intrude into an area occupied by an existing comprehensive statutory remedy.

The Commission suggests that because Congress created an expanded remedy by enacting § 11, it would be anomalous for the Court to limit purchasers in registered offerings to that remedy. Commission Brief at 19-20. In *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 713, 736 (1975), the Court recognized that the anomaly would arise if the Court should impute to Congress the intent to provide a judicially implied cause of action which exceeds the bounds of comparable express causes of action. In the present case, the Commission is suggesting that the Court should provide an implied cause of action which exceeds the bounds estab-

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[8]In *Higginbotham* the Court was dealing with federal common law created pursuant to art. III, § 2, of the Constitution, which extends federal judicial power to "all Cases of admiralty and maritime Jurisdiction." *See Southern Pac. Co* v. *Jensen*, 244 U.S. 205, 214-15 (1917). The authority of the federal courts to create a federal common law of securities fraud pursuant to § 10(b) is a considerably more doubtful proposition.

lished by Congress, not for a comparable cause of action, but for precisely the same cause of action.

The plaintiffs and the Commission have suggested two additional lines of argument which they contend permit the federal courts to ignore the express provisions of § 11. First, they have suggested that § 16 of the 1933 Act, 15 U.S.C. § 77p, indicates Congress' intent that § 11 not be the exclusive remedy for false or misleading registration statements. Commission Brief at 15. They argue, in effect, that by enacting § 16 Congress intended in 1933 to permit the federal courts to create a federal common law of securities fraud under the aegis of § 10(b) of the yet to be enacted 1934 Act and thereby to repeal[9] the carefully wrought provisions of § 11. Section 16 and Section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a), are, however, only savings clauses. Congress did not intend by enacting those provisions to imply that it contemplated the creation of remedies under § 10(b) different from those it had contemporaneously enacted in the same legislation. Rather, as is apparent from the language of the statute, Congress' intent was simply to

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[9]Plaintiffs or the Commission may suggest that repeal is not the appropriate term, since they would argue that the § 10(b) remedy would only "supplement" the express remedy of § 11. As the Court recognized, however, in *Higginbotham, supra,* supplementation is merely a euphemism for repeal. Thus, if the liability of an underwriter for damages resulting from a false and misleading registration statement is unlimited when suit is brought under § 10(b), the provisions of § 11(e) limiting that underwriter's liability to "the total price at which the securities underwritten by him and distributed to the public were offered to the public" are repealed. Similarly, if a plaintiff may, as the plaintiffs have done in the instant case, sue under § 10(b) persons such as the general contractor for the speedway and the attorneys for the underwriters, J.A. 22a, 23a, the statutory scheme of § 11 in which those persons are excluded from liability has been repealed for purposes of that litigation.

acknowledge that remedies might exist outside of "this title." Sections 16 and 28(a) are savings clauses which, as the legislative history and contemporary commentary reveal, were enacted in order to make clear that Congress did not intend for the federal securities laws to preempt existing common law. *See, e.g., Stock Exchange Practices: Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 before the Sen. Banking and Currency Comm.*, 73d Cong., 1st Sess. at 6577 (1934); Douglas and Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 198 & n. 155 (1933); Shulman, *Civil Liability and the Securities Act*, 43 Yale L.J. 227, 242 (1933). *Accord, Independence Shares Corp.* v. *Deckert*, 108 F.2d 51, 54 (3d Cir. 1939), *rev'd on other grounds*, 311 U.S. 282 (1940).

In *Milwaukee* v. *Illinois*, 451 U.S. 304 (1981) and in *Middlesex Cty. Sewerage Auth.* v. *Nat. Sea Clammers*, 453 U.S. 1 (1981), the Court rejected preservation of remedies arguments based upon § 505(e) of the Federal Water Pollution Control Act, 33 U.S.C. § 1365(e) and § 105(g)(5) of the Marine Protection, Research, and Sanctuaries Act of 1972, 33 U.S.C. § 1415(g)(5). Those arguments are considerably more forceful than the arguments made here, because each of the additional remedies urged in those cases existed when the preservation of remedy provisions were enacted. Further, the alternative remedy rejected in *Middlesex* was the *express* remedy provided by 42 U.S.C. § 1983, not an implied remedy with the dubious provenance of the § 10(b) private action. Nevertheless, the Court in *Middlesex* held that the remedy of suits under § 1983 is precluded "[w]hen the remedial devices provided in a particular act are sufficiently comprehensive . . . ." 453 U.S. 1, 101 S.Ct. at 2626.

Finally, we must deal with the doctrine of legislative reenactment. Basing their position primarily on the Court's recent holding in *Curran, supra*, plaintiffs and the Commis-

sion argue that because of various extensive amendments to the federal securities laws, including the Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494, none of which affirmatively adopts or renounces the holdings in *Fischman* and its progeny, Congress has by implication endorsed the doctrine that remedies under the federal securities laws should be "cumulative." Plaintiffs Brief at 34-37; Commission Brief at 13.[10] Congress has, however, never reenacted § 10(b), as it had reenacted the statutes construed in *Albemarle Paper Co.* v. *Moody*, 422 U.S. 405, 414 n. 8 (1975); *NLRB* v. *Gullett Gin Co.*, 340 U.S. 361, 366 (1951); and *National Lead Co.* v. *United States*, 252 U.S. 140, 147 (1920); nor has Congress enacted any new law incorporating therein § 10(b), as it had enacted new laws incorporating previously construed statutes in *Curran* and in *Lorillard* v. *Pons*, 434 U.S. 575 (1978).[11]

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[10]The argument made by the Commission parallels an argument made by it in *SEC* v. *Sloan*, 436 U.S. 103 (1978). The statute there being construed, § 12(k) of the 1934 Act, 15 U.S.C. § 781(k), was enacted in 1975 to consolidate § 19(a)(4) of the 1934 Act, 15 U.S.C. § 78s(a)(4), dealing with summary suspensions by the Commission of trading in listed securities, and § 15(c)(5) of the 1934 Act, 15 U.S.C. § 78o(c)(5), which had been enacted in 1964 to extend Commission summary suspension power to unlisted securities. Although Congress had in both 1964 and 1975 enacted legislation regarding § 12(k) or its predecessor and although the Senate Committee of Banking and Currency in connection with the 1964 legislation was specifically apprised of the Commission's administrative practice concerning repetitive summary suspensions and did not disapprove of it, S. Rep. No. 379, 88th Cong., 1st Sess. 66-67 (1963), the Court nevertheless declined to accept the Commission's argument of legislative reenactment. 436 U.S. at 119-121.

[11]The thrust of the argument made by plaintiffs and the Commission is that the doctrine of legislative reenactment freezes as of the enactment date of one of various amendments to the federal

Plaintiffs and the Commission rely upon congressional silence in 1964, 1975, and 1977 to accomplish the result for which they contend. That such silence is particularly uninformative is evident from the history of amendments proposed to the securities laws in 1954 and 1956, when Congress affirmatively acknowledged its understanding that §§ 11 and 12 of the 1933 Act provide the exclusive federal civil remedies in the circumstances to which they are addressed. H. R. Rep. No. 2513, 84th Cong., 2d Sess. at 5, 31-32 (1956); S. Rep. No. 1036, 83d Cong., 2d Sess. 5-6, 17-18 (1954); *Securities Exchange Acts Amendments: Hearings Before a Subcommittee of the Senate Committee on Banking and Currency on S. 2846,* 82d Cong., 2d Sess. at 32 (1954).[12]

More importantly, plaintiffs and the Commission do not simply suggest that Congress has by implication approved a construction of an ambiguous provision of § 10(b). They suggest that by implication Congress has endorsed the intrusion of a judicially-created remedy into an area already occupied by § 11 and that where, as a result of that intrusion, a conflict arises between the "restricted" remedy created by Congress and the broader remedy created by the courts, the courts should give priority to the broader

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securities laws – the plaintiffs and the Commission do not specify the particular amendment and the particular date – the prevailing holdings of the federal courts on issues arising under § 10(b). The Court is left to select from among legislation enacted in 1964, 1975, and 1977. The truth is that the whole exercise of seeking to discern from the enactment of any amendment to the federal securities laws a congressional intent to adopt the construction of § 10(b) then current is inappropriate. *See e.g., Consumer Product Safety Commission* v. *GTE Sylvania,* 447 U.S. 102, 118 n. 13 (1980).

[12]Accordingly, Congress did not approve the 1951 decision in *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951).

remedy in order to accomplish the remedial purposes of the federal securities laws.[13]

The plaintiffs and the Courts are, therefore, not asserting simply the doctrine of legislative reenactment. They are asserting the much more specific doctrine of repeal by implication; i.e., that as a result of the enactment of § 10(b) or as the result of other securities legislation enacted since 1933, Congress has by implication repealed, to the extent that investors elect to sue under § 10(b), the statutory scheme embodied in § 11. *See Ellis* v. *Carter,* 291 F.2d 270, 274 (9th Cir. 1961), upon which plaintiffs (Brief 29, 33) and the Commission (Brief 13, 16) rely, where the Court acknowledged that to imply a remedy under § 10(b) for transactions covered by §§ 11 or 12 of the 1933 Act "assumes that Congress in 1934 undid what it carefully did in 1933."

The Court has long been wary of the argument that laws have been repealed by implication. In *Georgia* v. *Pennsylvania R. Co.,* 324 U.S. 439 (1945), it addressed the issue as follows:

> But it is elementary that repeals by implication are not favored. Only a clear repugnancy between the old law

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[13]Plaintiffs' position is curious. They contend that there is no "overlap" between § 10(b) and § 11 unless plaintiffs could recover under both statutes. Plaintiffs Brief at 12. If this were true, the resolution of the overlapping remedies issue would be merely an academic exercise. The issue actually presented is whether a plaintiff, who has *standing* to sue under § 11 for alleged misrepresentations or material omissions in a registration statement and whose claim might or might not be successful, may also sue under § 10(b). In our analysis, a plaintiff has standing even though his claim is barred by limitations or even though the claim he wishes to make falls outside the statutory scheme. Thus, a plaintiff may not create a cause of action for himself under § 10(b) by purposely or inadvertently permitting his claim to become barred by limitations.

> and the new results in the former giving way and then only *pro tanto* to the extent of the repugnancy.

324 U.S. at 456-57.

There is, of course, no legislation enacted since 1933 which is wholly or even partially repugnant to § 11. The best evidence of repugnancy which plaintiffs and the Commission have offered is that the federal common law of securities evolved by the courts since *Kardon* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946), which reflects the remedial purposes of the securities laws, is repugnant to § 11 and that since Congress must be deemed to have been aware of this repugnancy, it has, by virtue of amendments to the federal securities laws enacted since *Kardon*, repealed § 11.

In *Morton* v. *Mancari*, 417 U.S. 535 (1974), the issue presented was whether the preference given to Indians in the Indian Reorganization Act of 1934, 25 U.S.C. § 461 et seq., was repealed by implication when Congress enacted the Equal Employment Opportunity Act of 1972, 42 U.S.C. § 2000e-16(a). In holding that no repeal by implication had occurred, the Court first alluded to the presumption against application of that doctrine, but further held:

> Where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment. *See, e.g., Bulova Watch Co.* v. *United States*, 365 U.S. 753, 758 (1961); *Rodgers* v. *United States*, 185 U.S. 83, 87-89 (1902).

417 U.S. at 550-51.

Section 11 is a clear, comprehensive, specific statute expressly dealing with civil liabilities arising from false and misleading registration statements. There is no other

federal legislation dealing expressly with the same subject. Under these circumstances, the federal courts may not alter, supplement, control, or nullify the statutory remedy established by Congress.

III. **The Court should consider the availability of § 17(a) to purchasers of registered securities.** Although the question presented in Herman & MacLean's petition for writ of certiorari includes the issue of the availability to purchasers of registered securities of a cause of action under § 17(a), neither the plaintiffs nor the Commission has briefed the issue. Plaintiffs claim that they have abandoned their § 17(a) claim by failing to object to the submission of a special interrogatory requiring scienter. Plaintiffs Brief at 4 n. 6. The Court in *Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680 (1980), held only, however, that scienter is not required by subparagraphs (2) and (3) of § 17(a). The scienter issue was required for plaintiffs' § 10(b) cause of action. In any event, the failure to except to the submission of a superfluous issue does not constitute abandonment of a claim. *See* Rule 49(a), Fed. R. Civ. P.

The Commission contends that the Court should not consider the issue because "any relief available under Section 17(a) is also available under Section 10(b)" and because the court below did not address the issue. Commission Brief at 6 n. 1. The court below did not address the issue because it found a private remedy under § 10(b). Apparently the Commission is unwilling to concede, even *arguendo*, the possibility that the Court might deny plaintiffs the right to sue under § 10(b), thereby requiring a ruling on the availability of § 17(a) as an alternative.[14]

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[14] The Fifth Circuit on October 7, 1982 held in *Landry* v. *All American Assurance Co.*, Fed. Sec. L. Rep. (CCH) ¶ 98,823, that since § 17(a)(2) prohibits the same type of conduct as

In fact, both plaintiffs and the Commission are dissembling. For whatever reason, they simply prefer not to address the issue. Nevertheless, the Court has granted a writ of certiorari, the issue is relevant to the disposition of this appeal, and the issue should be decided.

CONCLUSION

The holding of the court below that an implied remedy under § 10(b) or § 17(a) exists for registered offerings of securities should be reversed.

Respectfully submitted,

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§§ 11 and 12, but has none of the limitations applicable to those sections, no implied cause of action should be found under § 17(a). Although the plaintiffs in *Landry* also sued under § 10(b) and the analysis applicable to § 17 is equally applicable to § 10(b), the court did not rule on the availability of an implied remedy under § 10(b).

Amicus Brief

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF ARTHUR ANDERSEN & CO., AMICUS CURIAE

Arthur Andersen & Co. ("Andersen") submits this brief as *amicus curiae* in support of petitioner's position. The petition states as the "question presented":

> Does an implied remedy exist under either § 10(b) of the Securities Exchange Act of 1934 or § 17(a) of the Securities Act of 1933 for purchasers of securities who have an express remedy under § 11 of the Securities Act of 1933 by virtue of the fact that the securities purchased were issued pursuant to a registration statement filed as required by § 5 of the Securities Act of 1933.

Interest of the Amicus Curiae

Andersen is an international accounting firm and one of the so-called "Big Eight." Accounting firms are major targets of private civil actions under § 10(b) and Rule 10b-5. Andersen shares the "concerns" described in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), namely, "the danger of vexatious litigation . . . from a widely expanded class of plaintiffs under Rule 10b-5"; the disproportionate "settlement value" of "a complaint which by objective standards may have very little chance of success at trial"; the fact that "[t]he very pendency of the lawsuit may frustrate or delay normal business activity"; "the potential for nuisance or 'strike' suits in this type of litigation" (*id.* at 740); and the fact that "[t]he potential for possible abuse of the liberal discovery provisions . . . may likewise exist in this type of case to a greater extent than they do in other litigation" (*id.* at 741). Andersen, therefore, has a vital interest in the issue of implied private civil remedies which expand the liability of accountants under § 10(b), Rule 10b-5 and § 17(a).

The Position of Accounting Firms in Relation to Litigation Under the Federal Securities Laws and the Express Remedies Thereunder

Accountants have a peripheral relationship to the coverage of the federal securities laws, since they are not sellers or buyers of securities; they are not brokers or insiders; and they are not involved with securities exchanges or over-the-counter markets. Their exposure results from their role with respect to corporate financial statements.

Corporate financial statements are prepared by the corporation, not by its outside auditors. The auditor examines such statements in accordance with generally ac-

cepted auditing standards and opines whether they present fairly the corporation's financial position and the results of its operations, in conformity with generally accepted accounting principles. The auditor's opinion may be "clean," be qualified or state exceptions; or there may be refusal to give an opinion.

Rule 10b-5 actions against outside auditors are generally based on alleged material misstatements or omissions in financial statements, claiming that the auditors did not uncover such misstatements or omissions because of non-compliance with generally accepted auditing standards.*

The financial statements are reproduced in the corporation's annual report, in registration statements under the 1933 Act and in documents filed with the SEC under the 1934 Act, particularly the so-called "10K reports." The plaintiff claims that he relied on the financial statements when buying or selling, and that he would not have bought or sold but for the alleged misstatements or omissions.

Before the federal securities acts, suits against accountants by third parties were cognizable only under state law. *See, e.g., Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 174 N.E. 441 (1931); *State Street Trust Co.* v. *Ernst,* 278 N.Y. 104, 15 N.E.2d 416 (1938). However, with the expansion of litigation under Rule 10b-5, such actions are now routinely brought in the federal courts.

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* This constitutes negligence, not fraud. However, because *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), requires fraud, and left open the issues whether "reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5" (*id.* at 194 n.12), and "whether civil liability for aiding and abetting is appropriate under the section and the Rule" (*id.* at 192 n.7), the complaints against auditors now automatically allege fraud, recklessness, and aiding and abetting liability.

The Express Remedies in the 1933 and 1934 Acts

Section 11 of the 1933 Act, 15 U.S.C. § 77k, recognizing the significance of audited financial statements in registration statements, expressly authorizes private suits by "any person" based on an "untrue statement of a material fact" or an omission. Section 11 lists the persons who may be sued, including "every accountant . . . who . . . certified any part of the registration statement . . ." ((a)(4)); prescribes the attributes of such a suit, including plaintiff's required "proof" and the knowledge which would bar his suit ((a)(5)); describes the defendant's "burden of proof" to preclude liability (b), which includes "reasonable ground to believe" after "reasonable investigation" ((b)(3)); defines "the standard of reasonableness" (c); prescribes the formula for determining damages (e); fixes a ceiling on "the amount recoverable" (g); authorizes "contribution" (f); and fixes a statute of limitations of "one year after the discovery of the untrue statement or the omission," but not to exceed "three years after" the offer or sale (§ 13, 15 U.S.C. § 77m). Recognizing "the potential for nuisance or 'strike' suits in this type of litigation," *Blue Chip Stamps*, 421 U.S. at 740, Congress authorized "reasonable attorney's fees" for the prevailing party (§ 11(e)).

Section 12(2) of the 1933 Act, 15 U.S.C. § 77l, limits recovery to those in "privity," *see, e.g., Collins* v. *Signetics Corp.*, 605 F.2d 110 (3d Cir. 1979), and § 15, 15 U.S.C. § 77o, limits liability of persons, other than primary violators, in accordance with a precise "controlling person" provision.

The 1934 Act requires certain reports to be filed with the SEC, and § 18, 15 U.S.C. § 78r, expressly authorizes private civil actions against "[a]ny person," which includes accountants, making a statement in any "report" so

filed (a). Here, too, Congress delineated the various aspects of the action, including the same "one year" and "three years" statutes of limitations (c), and recovery of "reasonable attorney's fees" (a).* Other sections of the 1934 Act also expressly provide for private civil remedies with clearly delineated boundaries. *See, e.g.,* §§ 9, 16 and 20, 15 U.S.C. §§ 78i, 78p and 78t.

In addition to such express private civil remedies, both Acts expressly confer authority to sue on government officials. *See, e.g.,* §§ 20 and 22 of the 1933 Act, 15 U.S.C. §§ 77t and 77v; §§ 21 and 27 of the 1934 Act, 15 U.S.C. §§ 78u and 78aa.

Such provisions for express civil remedies were enacted after extensive public hearings at which affected persons, such as accountants, were represented; the views of the accounting profession were presented; proposed provisions were modified to give partial effect to such views;** the House and Senate Committees issued their reports; and the legislative process functioned, as intended. Since these were "landmark statutes," *Blue Chip Stamps,* 421 U.S. at 727, they had particularly careful Congressional and public scrutiny.

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* As one court stated, the sections which expressly provide for private civil remedies amount "to a code of procedure." *Rosenberg* v. *Global Aircraft Corp.,* 80 F. Supp. 123, 124 (E.D. Pa. 1948).

** Much of this legislative history, including the participation of the "accounting profession," is described in *Hochfelder,* 425 U.S. at 211-12 n.31.

Section 10(b) of the 1934 Act and Rule 10b-5 Thereunder

As *Piper* v. *Chris-Craft Industries,* 430 U.S. 1, 24-25 (1977), states, "§ 10(b) makes no provision whatever for a private cause of action, such as those explicitly provided in other sections of the 1933 and 1934 Acts." Moreover, as stated in *Hochfelder,* 425 U.S. at 196, "§ 10(b) does not by its terms create an express civil remedy for its violation, and *there is no indication that Congress, or the Commission when adopting Rule 10b-5, contemplated such a remedy . . . .*"* And in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran,* —— U.S. ——, 102 S.Ct. 1825, 1845 n.38 (1982), this Court, referring to congressional approval of an implied cause of action under the Commodities Exchange Act, noted that "*no comparable legislative approval or acquiescence exists for the Rule 10b-5 remedy.*" *See also Blue Chip Stamps,* 421 U.S. at 723.

As *Hochfelder,* 425 U.S. at 212-13 n.32, states, "the Rule was a hastily drafted response to a situation clearly involving intentional misconduct," in order to empower the SEC to proceed against a buyer of securities who was defrauding sellers. *Hochfelder* cites the only published statement of how the Rule happened to be promulgated, namely, a statement by "one of the Rule's codrafters" (*id.*).** He stated that an SEC official needed authority to proceed against a corporate president, who was flagrantly misrepresenting earnings and buying stock substantially below real value. The draftsman simply put "Section 10(b) and . . . Section 17 . . . together," and then

* Unless otherwise noted, italics in quoted material have been supplied.

** Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967). The statement by the draftsman of Rule 10b-5 is quoted extensively in *Lanza* v. *Drexel & Co.,* 479 F.2d 1277, 1290 n.32 (2d Cir. 1973) and in Justice Blackmun's dissenting opinion in *Blue Chip Stamps,* 421 U.S. at 767.

met with the commissioners either "that morning or after lunch. . . . All the commissioners read the rule and they tossed it on the table, indicating approval." 22 Bus. Law., *supra,* at 922.

The draftsman of Rule 10b-5 then stated:

> It [Rule 10b-5] was intended to give the Commission power to deal with this problem. *It had no relation in the Commission's contemplation to private proceedings.* How it got into private proceedings was by the ingenuity of members of the private Bar starting with the *Kardon* case. [*] It has been developed by the private lawyers . . . with the . . . connivance of the federal judiciary, who thought this was a very fine fundamental idea and that it should be extended. *Id.*

Even though the draftsman made it so clear that the Rule was intended to apply only to proceedings brought by the SEC, the Rule is now the vehicle for substantially all private civil litigation under the federal securities laws. A claim against accountants which fits the precise mold of express remedies in the Acts is nevertheless brought under Rule 10b-5, denying them the protection built into such provisions. The statute of limitations is thereby expanded from one year after discovery of the fraud, or three years after accrual of the cause of action, to whatever may be the fraud statutes in the particular state in which the suit is brought, which, as *Hochfelder* noted, 425 U.S. at 210 n. 29, "usually are longer than the period provided under § 13" and the other sections which prescribe express remedies; a ceiling on damages is replaced with unlimited liability; requirements of "privity" are eliminated; opportunity to recover reasonable attorneys' fees for "nuisance and 'strike' suits" is eliminated; and other protections prescribed by Congress and developed in the course of the above described legislative process are nullified.

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* *Kardon* v. *National Gypsum Co.,* 69 F. Supp. 512 (E.D. Pa. 1946), discussed below.

The Distinction Between Implying a Private Civil Remedy Under a Section of a Statute Which Becomes Operative on the Effective Date of the Statute, and Implying Such a Remedy Under § 10(b) of the 1934 Act, Which Could Become Effective Only After the SEC Issued a Rule

Unlike the above sections of the 1933 and 1934 Acts which "create an express civil remedy for its violation" and which became operative when the Acts became effective, § 10(b) did not become operative when the 1934 Act became effective.* Section 10(b) prohibits certain acts when done "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Accordingly, when the 1934 Act became effective, § 10(b) was in limbo, and could become operative only when the SEC decided what was needed "in the public interest or for the protection of investors" and issued the requisite "rules and regulations." The SEC did not do this until May 21, 1942, when Rule 10b-5 was issued. It was only then, if at all, that an implied private civil remedy could be deemed created, and any such creation would have been done by an administrative agency, not Congress.

* This Court's many recent decisions on "whether a private remedy is implicit in a statute not expressly providing one," *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 562 (1979), also concern a section of a statute which became operative when the statute became effective, *Santa Clara Pueblo* v. *Martinez*, 436 U.S. 49 (1978); *Chrysler Corp.* v. *Brown*, 441 U.S. 281 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979); *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11 (1979); *Universities Research Assn., Inc.* v. *Coutu*, 450 U.S. 754 (1981); *Northwest Airlines, Inc.* v. *Transport Workers*, 451 U.S. 77 (1981); *California* v. *Sierra Club*, 451 U.S. 287 (1981); *Texas Industries, Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630 (1981); *Middlesex Cty. Sewerage Auth.* v. *Sea Clammers*, 453 U.S. 1 (1981); *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 102 S.Ct. 1825 (1982).

The scope and reach of any implied private civil remedy, and the extent to which it overlapped an express remedy or nullified specific limitations, protections and defenses enacted in respect of such express remedy, or extended the applicable statute of limitations, would all be determined by what rule the agency years later decided to issue "in the public interest" or for "the protection of investors." Therefore, a holding that there is an implied private civil remedy under § 10(b) is in effect a holding that Congress intended to delegate to the SEC the power to create such a private civil remedy, in whatever area and to whatever extent the agency deemed "necessary or appropriate," and regardless of its impact on the carefully enacted express remedies. Such delegation to an administrative agency of the power to confer jurisdiction on the federal court presents a serious constitutional issue.*

The issue of an implied private civil remedy will nevertheless be considered herein as though § 10(b) itself incorporated the language of Rule 10b-5, so that its effectiveness would not be dependent on agency action.

Summary of Argument

Section 10(b) of the 1934 Act, Rule 10b-5 thereunder and § 17(a) of the 1933 Act do not expressly provide for a private civil remedy. This Court's recent decisions uniformly hold "the dispositive question" is whether Congress intended to create a private civil remedy by im-

* Only Congress "has the power to determine . . . the jurisdiction of the courts of which it is the creator." *City of Pittsburgh* v. *Pennsylvania P.U.C.*, 512 F. Supp. 1117, 1121 (W.D. Pa. 1981). Therefore, only Congress can establish private civil causes of action, expressly or by implication. Congress could not delegate to an administrative agency authority to confer jurisdiction on federal courts, on the basis of an agency rule which creates an implied private civil remedy. *Cf. Schechter Poultry Corp.* v. *United States*, 295 U.S. 495, 529 (1935); *American Textile Mfrs. Institute, Inc.* v. *Donovan*, 452 U.S. 490, 543-48 (1981) (Rehnquist, J. dissenting).

plication and that the issue is solely one of statutory construction.

When Congress wished to create private rights of action under the federal securities laws, it expressly provided for them. Congress intended the express remedies to be the exclusive means of enforcing the duties and obligations imposed by the Acts, and did not intend to empower an administrative agency to create overlapping remedies which would supersede restrictions placed on such express remedies.

Section 10(b) could not become operative until the SEC issued Rule 10b-5, eight years after the Act became effective. It was not the intent of Congress in effect to delegate to an administrative agency the power to create private civil remedies. Any such intent would be an unlawful delegation of congressional power to confer jurisdiction on lower federal courts.

The legislative history of § 17(a) of the 1933 Act makes clear that civil liability would not attach for a violation thereof. Rule 10b-5 uses the same language as § 17(a). This Court has held that there is no implied private civil remedy under § 206 of the Investment Advisers Act of 1940, which also uses the same language as § 17(a). If such language, as used in both § 17(a) of the 1933 Act and § 206 of the 1940 Act, does not create an implied civil remedy, neither does the identical language as used in Rule 10b-5. Also, the draftsman of Rule 10b-5 made it clear that its sole purpose was to empower the SEC to proceed against fraudulent buyers of securities and that there was no intent to create an implied civil remedy.

Finally, policy considerations require that this Court curb the escalating recourse to private damage suits which has placed a severe and growing burden on the lower federal courts.

ARGUMENT

POINT I

There is no implied private civil remedy under Rule 10b-5 where there is an applicable express remedy under the 1933 or 1934 Acts.

A. The "dispositive question" is whether Congress intended to create the implied private civil remedy.

Blue Chip Stamps, supra, 421 U.S. at 730, noted that *Kardon* was the first case to hold "that there was an implied private right of action in the Rule," and that it had "had no occasion to deal with the subject until 25 years later," when it "confirmed" existence of such an implied cause of action "with virtually no discussion."* *Aaron* v. *SEC,* 446 U.S. 680, 689 (1980), confirms that this Court merely "assumed the existence of an implied cause of action under § 10(b) and Rule 10b-5. . . ." Such statements refer to one sentence in a footnote in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 13 n.9 (1971), which states that "[i]t is now established that a private right of action is implied under § 10(b)." *Superintendent,* however, involved a claim not covered by an express civil remedy. This Court has not had "occasion to pass on" "the question of whether an implied action under § 10(b) of the 1934 Act and Rule 10b-5 will lie for actions made in violation of the 1933 Act and the subject of express civil remedies under the 1933 Act," *Blue Chip Stamps,* 421 U.S. at 752 n.15.

Redington, supra, and *Transamerica, supra,* prescribe a precise and definite test for determining whether a pri-

* The lower courts which found the existence of a private civil remedy under Rule 10b-5, which this Court "confirmed . . . with virtually no discussion," also had "not even discussed the question of whether a private right exists" and "contented themselves with referring to cases already decided," which likewise did not discuss the question. *See* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent,* 57 Nw. U.L.Rev. 627, 635 (1963).

vate right of action should be implied under the federal securities laws. *Redington*, which held that there is no "implied cause of action for damages under § 17(a) [of the 1934 Act] against accountants," made clear that the "central inquiry" is "whether Congress intended to create, either expressly or by implication, a private cause of action." 442 U.S. at 562, 575.

Transamerica, which held that there is no implied cause of action for damages under § 206 of the Investment Advisers Act of 1940, stated that "[t]he question whether a statute creates a cause of action, either expressly or by implication, is basically a matter of statutory construction," 444 U.S. at 15; "what must ultimately be determined is whether Congress intended to create the private remedy asserted, as our recent decisions have made clear." *Id.* at 15-16. After a comprehensive analysis of the statute, *Transamerica* stated:

> The *dispositive question* remains whether Congress intended to create any such remedy. Having answered that question in the negative, our inquiry is at an end. *Id.* at 24.*

B. The statutory scheme, with its inclusion of express statutory remedies, particularly those as explicit as the ones in the 1933 and 1934 Acts, precludes concurrent or overlapping implied private civil remedies under § 10(b) and Rule 10b-5.

In considering whether there is an implied private civil remedy under § 10(b), "analysis begins, of course, with the statute itself . . . . § 10(b), makes no provision what-

* *See also Passenger Corp.* v. *Passengers Ass'n*, 414 U.S. 453, 456 (1974) ("support for the bringing of this action must be found, if at all, within the four corners of that Act"); *Sierra Club, supra*, 451 U.S. at 293 ("the ultimate issue is whether Congress intended to create a private right of action"); *Middlesex, supra*, 453 U.S. at 13 ("The key to the inquiry is the intent of the Legislature").

ever for a private cause of action, such as those explicitly provided in other sections of the 1933 and 1934 Acts." *Piper, supra,* 430 U.S. at 24. *Hochfelder, supra,* 425 U.S. at 196, also recognized that "§ 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication that Congress, or the Commission when adopting Rule 10b-5, contemplated such a remedy."

Aaron, supra, 446 U.S. at 691, observed that "*Hochfelder* involved an implied cause of action that was not within the contemplation of the Congress that enacted § 10(b)."

Transamerica, supra, 444 U.S. at 19, stressed the "elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it."

Passenger Corp., supra, 414 U.S. at 458, held that where the Amtrak Act expressly granted a particular private civil remedy to a specified class of persons, "courts should not expand the coverage of the statute to subsume other remedies."

Referring to the "ancient maxim—*expressio unius est exclusio alterius,*" this Court then stated:

> Since the Act creates a public cause of action for the enforcement of its provisions and a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created in § 307(a) are the exclusive means to enforce the duties and obligations imposed by the Act.

The same principle of statutory construction was emphasized in *Redington, supra,* 442 U.S. at 571-72, which also looked at the "statutory scheme" and particularly noted that "§ 18(a) creates a private cause of action against persons, such as accountants, who 'make or cause to be made' materially misleading statements in any reports or

other documents filed with the Commission. . . ." *Redington* further stated (*id.*):

> Further justification for our decision not to imply the private remedy that SIPC and the Trustee seek to establish may be found in the statutory scheme of which § 17(a) is a part. *First, § 17(a) is flanked by provisions of the 1934 Act that explicitly grant private causes of action.* § 16(b), 15 U.S.C. § 78p(b); § 18(a), 15 U.S.C. § 78r(a). Section 9(e) of the 1934 Act also expressly provides a private right of action. 15 U.S.C. § 78i(e). See also § 20, 15 U.S.C. § 78t. Obviously, then, *when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly.**

Section 10(b), like § 17(a), is also "flanked by provisions of the 1934 Act that explicitly grant private causes of action." And, as shown above, "a private cause of action . . . [is] explicitly provided in other sections of the 1933 and 1934 Acts." *Piper, supra,* 430 U.S. at 24.

Middlesex, supra, which held that Congress did not intend to create a private right of action under certain statutes, stressed the fact that "[t]hese Acts contain unusually elaborate enforcement provisions, conferring authority to sue for this purpose *both on government officials and private citizens.*" 453 U.S. at 13. The 1933 and 1934 Acts, as above described, also contain "elaborate enforcement provisions, conferring authority to sue . . . *both on government officials and private citizens.*"

As already shown, § 11 of the 1933 Act and § 18 of the 1934 Act both expressly provide for private civil suits against accountants. The judge who decided the "seminal *Kardon* decision," *Blue Chip Stamps, supra,* 421 U.S. at 730, refused a year and a half later in *Rosenberg, supra,* 80 F. Supp. at 124, to imply a cause of action under § 10(b)

* This language was quoted and followed in *Universities Research, supra,* 450 U.S. at 773.

of the 1934 Act, based on alleged "manipulative or deceptive devices" expressly covered by that section, because Congress had provided specific remedies in both the 1933 Act and the 1934 Act:

> By any reasonable rule of statutory interpretation, it would require either an express repeal or an implication of repeal so strong as to be inescapable. The two Acts are unquestionably in pari materia and must be construed together to make a consistent whole. Looking at them as one statute *it is simply not possible that Congress, having prescribed in elaborate detail procedural requirements which must be fulfilled in order to enforce civil liability attaching to a carefully defined type of violation, would have casually nullified them all in a later section.*

This reasoning was recently adopted in *Berger* v. *Bishop Investment Corp.*, 528 F. Supp. 346, 349 (E.D. Mo. 1981), which relied on *Rosenberg, supra,* in dismissing the complaint:

> [W]here a plaintiff has an express civil remedy under § 12(2) of the 1933 Act, he may not avail himself of an implied cause of action under § 10b of the 1934 Act and Rule 10b-5.

In *Greater Iowa Corp.* v. *McLendon,* 378 F.2d 783, 790 (8th Cir. 1967), the court stated:

> Section 12 [of the 1933 Act] provides a private civil remedy to "purchasers." We think this is the civil remedy given to private parties by the framers of the Act, and excludes establishment of additional private civil remedies. Had Congress desired to extend the private civil remedy it could have done so by the addition of only a few words.

See also Montague v. *Electronic Corp. of America,* 76 F. Supp. 933, 936 (S.D.N.Y. 1948); 3 Loss, *Securities Regulation* 1787-91 (2d ed. 1961); 6 Loss, *Securities Regulation* 3916-17 (1969).

C. There is no legislative history suggesting a private remedy under § 10(b). The circumstances of promulgating Rule 10b-5 show an intent not to create an implied private remedy.

Since there is nothing in the legislative history which suggests that Congress intended a private remedy under § 10(b) or under such rule as the SEC might at some future date promulgate, relevant is the statement in *Redington*, 422 U.S. at 571, in dealing with § 17(a) of the 1934 Act, that "the fact that there is no suggestion whatsoever in the legislative history that § 17(a) may give rise to suits for damages reinforces our decision not to find such a right of action implicit within the section." The above described circumstances as to the issuance of Rule 10b-5 show that the sole intent of its draftsman was "to give the Commission the power to deal with this problem" of fraud by a purchaser inducing sale of securities, and that there was no intent to authorize "private proceedings." 22 Bus. Law., *supra*, at 922.

As already noted, the draftsman simply put together § 17(a) of the 1933 Act and § 10(b) of the 1934 Act. *Hochfelder* recognized that "the language of the rule appears to have been derived in significant part from § 17 of the 1933 Act." 425 U.S. at 212-13 n.32. The legislative history of the 1933 Act is clear that Congress did not intend to create a private civil remedy under § 17(a). The House Committee Report, in listing the sections that "define the civil liabilities imposed by the act," pointed only to Sections 11 and 12. H.R. Rep. No. 85, 73d Cong., 1st Sess. 9-10 (1933).

Senator McGill, explaining a proposed amendment to § 17, stated:

> It is to be noted that enforcement of the provisions of the new subsection is left to injunction, stop order, and criminal prosecution. *No civil liability attaches for any violation thereof.* 78 Cong. Rec. 8712 (1934).

Commissioner Landis of the Federal Trade Commission, who was active in drafting the statute, which the FTC was originally designated to enforce, stated:

> The suggestion has been made on occasion that civil liabilities arise also from a violation of Section 17. . . . But a reading of this section in the light of the entire Act leaves no doubt but that violations of its provisions give rise only to a liability to be restrained by injunctive action or, if wilfully done, to a liability to be punished criminally.

Landis, *Liability Sections of Securities Act Authoritatively Discussed,* 18 Am. Accountant 330, 331 (1933).

Contemporaneous commentators found no basis for implying civil remedies under § 17. An article co-authored by then Professor William O. Douglas states:

> Section 17 probably does not enlarge civil remedies of purchasers. This seems clear by negative implication, since Sections 11 and 12 expressly state the remedies which are available.

Douglas & Bates, *The Federal Securities Act of 1933,* 43 Yale L. J. 171, 181-82 (1933).

Professor Harry Shulman's article, *Civil Liability and the Securities Act,* 43 Yale L. J. 227 (1933), does not even mention § 17. And Professor Loss found no reason to "add an implied remedy under § 17(a) of the 1933 act to the detailed remedies specifically created by §§ 11 and 12." 3 Loss, *Securities Regulation* 1785 (2d ed. 1961).

In short, as stated in *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J. concurring), *cert. denied,* 394 U.S. 976 (1969):

> [T]here is unanimity among the commentators, including some who were in a peculiarly good position to know, that § 17(a)(2) of the 1933 Act—indeed the

whole of § 17—was intended only to afford a basis for injunctive relief and, on a proper showing, for criminal liability, and was never believed to supplement the actions for damages provided by §§ 11 and 12.

If the language of § 17(a) of the 1933 Act and its legislative history are not sufficient to show that Congress intended an implied civil remedy, then clearly there is no basis for the conclusion that Congress intended that, if the SEC incorporated the language of § 17(a) into a rule under § 10(b), an implied civil remedy could thereby be created under such rule.

D. Prior decisions which implied a private civil remedy were based either on principles of tort law or on a judicially-created remedy and accordingly have been overruled by *Redington, Transamerica* and other recent Supreme Court decisions.

Prior cases which found or simply assumed existence of a private remedy under Rule 10b-5, or under a section of the Acts which did not provide an express remedy, were based either on the general law of torts, as in *Kardon,* or on inherent judicial power to effectuate an alleged Congressional purpose, as in *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964).

Kardon found an implied private right of action under Rule 10b-5 solely on "basic principles of tort law." 69 F. Supp. at 514. Misdescribing Rule 10b-5 as a statute, *Kardon* stated that "[t]he disregard of the command of a statute is a wrongful act and a tort . . . . 'This is but an application of the maxim, Ubi jus ibi remedium,' " *id.* at 513.

Kardon stated that the question was not "one of statutory interpretation," but "whether an intention can be implied to deny a remedy and to wipe out a liability which, normally, *by virtue of basic principles of tort law,* accom-

panies the doing of the prohibited act." *Id.* at 514. It further held that where a private remedy "is not expressly denied the intention to withhold it should appear very clearly and plainly." *Id.* It is such inverted reasoning which spawned so much Rule 10b-5 litigation.

However, *Redington* held that the question "is, of course, *one of statutory construction,*" and that an "argument in favor of implication of a private right of action *based on tort principles, therefore, is entirely misplaced,*" 442 U.S. at 568. Accordingly, *Kardon* and its progeny—which based the private remedy on "the general law of torts"—have been overruled.

Borak, supra, 377 U.S. 426, cited in *Superintendent* to support its one sentence statement that "a private right of action is implied under § 10(b)"—did not purport to address Congressional intent, or to analyze the statute, or to consider the provisions for express remedies as relevant to Congressional intent to imply others, or to examine legislative history. *Borak* made it clear that the remedy was not created by the statute, expressly or impliedly, but by the Court. *Borak* deemed it "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose" (*id.* at 433), and held that, because the purpose of the 1934 Act was " 'the protection of investors'," this "implies the availability of judicial relief where necessary to achieve that result." *Id.* at 432. As noted in *Piper,* 430 U.S. at 25, *Borak* simply decided "that because of practical limitations upon the SEC's enforcement capabilities, '[p]rivate enforcement . . . provides *a necessary supplement to Commission action*' " (italics added by the Court).

Redington made clear *Borak's* lack of current viability, 442 U.S. at 578:

> The invocation of "remedial purposes" of the 1934 Act is similarly unavailing. Only last Term, we em-

> phasized that generalized references to the "remedial purposes" of the 1934 Act will not justify reading a provision "more broadly than its language and the statutory scheme reasonably permit." . . . To the extent our analysis in today's decision differs from that of the Court in *Borak*, it suffices to say that in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action, and we follow that stricter standard today. . . . *The ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law.**

Redington and *Transamerica* both overrule the decision in *Borak* that courts must "provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. at 433.

POINT II

There is no implied private civil remedy under § 17(a) of the 1933 Act where there is an applicable express remedy under such Act.

The foregoing discussion, which establishes that Congress did not intend to create a private civil remedy under § 10(b) as a concurrent or overlapping remedy with those expressly provided, applies to the separate issue whether Congress intended to create a private civil remedy under § 17(a) of the 1933 Act. Certain additional factors applicable to § 17(a) further lead to the conclusion that there is no such implied remedy under § 17(a).

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* Lower courts have gotten the message. Thus, *CETA Workers' Organizing Committee* v. *City of N.Y.*, 617 F.2d 926, 932 (2d Cir. 1980), recognized that recent Supreme Court decisions have "cautioned us not to look abstractly at the 'desirability' of inferring private rights of action thought *by us* to provide remedies effectuating the purposes of the given statute . . . ." (Emphasis by the court.)

First, while this Court "assumed" with "virtually no discussion," except for one sentence in a footnote in *Superintendent,* that there is such a private remedy under Rule 10b-5, this Court made no comparable assumption as to a private remedy under § 17(a), but expressly left the issue open. *See Aaron,* 446 U.S. at 689; *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551, 557 n.9 (1979); and *Blue Chip Stamps,* 421 U.S. at 733 n.6. Therefore, in now considering this question, this Court is not faced with a prior assumption that a private civil remedy exists. Nor is it faced with many lower court decisions, as there are with respect to the issue under Rule 10b-5.*

Second, unlike § 10(b), there is substantial legislative history which establishes that Congress did not intend a private civil remedy under § 17(a). Illustrative is Senator McGill's flat statement above quoted, that "*No civil liability attaches for any violation thereof.*" Also, the agency which then had cognizance of the 1933 Act had "no doubt" that there was no civil liability thereunder, and that "violations of its provisions give rise only to a liability" to an injunction or criminal sanctions (*see* pp. 16-18, *supra*).

Third, since § 206 of the Investment Advisors Act contains the identical language of § 17(a) of the 1933 Act, *mutatis mutandis,* the *Transamerica* decision that such language does not create a private civil remedy would govern the issue whether the identical language in § 17(a) creates

* Many lower courts have concluded that there is no implied private civil remedy under § 17(a). *See, e.g., Shull* v. *Dain, Kalman & Quail, Inc.,* 561 F.2d 152, 159 (8th Cir. 1977), *cert. denied,* 434 U.S. 1086 (1978); *Hill* v. *Der,* 521 F. Supp. 1370 (D. Del. 1981). While *Kirshner* v. *United States,* 603 F.2d 234, 241 (2d Cir. 1978), *cert. denied,* 442 U.S. 909 (1979), expressed a contrary view, its decision was based on the Seventh Circuit's opinion in *Daniel,* 561 F.2d 1223, 1244-46 (7th Cir. 1977). This Court's reversal of *Daniel* specifically noted that the issue under § 17(a) was still open, 439 U.S. at 557 n.9.

a private civil remedy. Actually, the case for holding that there is no private civil remedy under § 17(a) is far stronger than in *Transamerica*, since the 1933 Act expressly provides for private causes of action in several sections, whereas, as this Court noted in *Transamerica*, "[t]he Investors Advisers Act nowhere expressly provides for a private cause of action." 440 U.S. at 14.

POINT III

There is no implied remedy under Rule 10b-5 or § 17(a), apart from whether the remedy sought to be implied would be concurrent with or overlap an express remedy.

While the foregoing, it is respectfully submitted, establishes that Congress did not intend that private civil remedies would be implied under § 10(b), Rule 10b-5 and § 17(a), where the Acts contain express civil remedies under which suit could be brought on the same facts, actually Congress did not intend to authorize any private civil actions under § 10(b) of the 1934 Act or § 17(a) of the 1933 Act. It is submitted that this broader question is fairly comprehended in the "question presented."*

This Court's recent decisions, above cited and quoted, which hold so unequivocally that "[t]he key to the inquiry is the intent of the Legislature," and which stress that existence of "elaborate enforcement provisions, conferring authority to sue . . . both on government officials and private citizens" evidences a congressional intent not to imply private civil remedies, *Middlesex, supra*, 453 U.S. at 13,

* In any event, this Court will consider an issue raised in an *amicus curiae* brief and not raised by petitioner. *Fry* v. *United States*, 421 U.S. 542, 545 n.5 (1975); *Blonder-Tongue Laboratories, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313, 319-20 n.6 (1971). *Cf. Erie R.R.* v. *Tompkins*, 304 U.S. 64, 68-69 (1938).

likewise apply to the broader issue herein discussed of whether Congress intended any implied civil remedies under § 17(a) or Rule 10b-5, apart from whether such an implied remedy would overlap an express one in the Acts.

Transamerica and *Redington* control, and they alone require a decision that there is no private civil remedy under § 10(b), Rule 10b-5 or § 17(a).

Section 206 of the Investment Advisers Act of 1940 contains language identical to § 17(a) of the 1933 Act, *mutatis mutandis*. Also, as shown above, the draftsman of Rule 10b-5 simply put together the language of § 17(a) and of § 10(b), so that Rule 10b-5 and § 206 also contain identical language. Accordingly, since *Transamerica* held that the language of § 206 does not create an implied private civil remedy, neither does the same language as contained in Rule 10b-5 and in § 17(a).

Actually, Rule 10b-5 and § 17(a) present a stronger case than § 206 for not implying a civil remedy. As stated in *Transamerica*, "[t]he Investment Advisors Act nowhere expressly provides for a private cause of action," 444 U.S. at 14, and it was the existence of express provisions for the public enforcement of § 206 which precluded an implied civil remedy. In the 1933 and 1934 Acts, however, Congress not only provided the same kind of administrative and criminal proceedings as in the Investment Advisers Act, but also expressly provided for private civil remedies. Therefore, to quote *Transamerica*, 444 U.S. at 20, the language of which is also applicable to § 10(b) and § 17(a):

> In view of these express provisions for enforcing the duties imposed by § 206, it is highly improbable that "Congress absentmindedly forgot to mention an intended private action." *Cannon* v. *University of Chicago*, 441 U.S., at 742 (Powell, J., dissenting).

Section 206 uses the language "[*i*]*t shall be unlawful for any investment adviser,*" and *Transamerica* states that "Section 206 simply proscribes certain conduct, and does not in terms create or alter any civil liabilities." However, § 10(b) uses the identical language, "[*i*]*t shall be unlawful for any person,*" except that, unlike § 206, § 10(b) did not proscribe any conduct at all, until the SEC issued "rules and regulations."

If Congress did not intend an implied private civil remedy under a section as precisely delineated as § 206, clearly it could not have intended an implied private civil remedy under "Section 10(b) [which] was designed as a catchall clause . . . ." *Chiarella* v. *United States,* 445 U.S. 222, 226 (1980).

Furthermore, *Redington* concluded on the basis of the entire "statutory scheme" that since Congress provided for express private civil remedies in the 1934 Act, as well as for government proceedings, it would not imply a remedy under a section of the 1934 Act which did not provide for one. Since § 10(b) of the 1934 Act is part of the same "statutory scheme," *Redington* is conclusive on the issue of an implied remedy under § 10(b).

Merrill Lynch, Pierce, Fenner & Smith v. *Curran, supra,* 102 S.Ct. 1825 (1982), does not require a contrary result. The majority opinion in *Merrill Lynch* is based on an express finding of legislative intent. As this Court there stated, "Congress was, of course, familiar . . . with the implied private remedy" under the Commodity Exchange Act, *id.* at 1841, and "Congress comprehensively reexamined the CEA in 1974 and did not amend the sections under which the cause of action had been implied," *id.* at 1845 n.88. Accordingly, this Court concluded that "Congress evidenced an affirmative intent to preserve this enforcement tool," *id.* at 1844.

However, while various sections of the 1933 and 1934 Acts have been amended from time to time, they have never been "comprehensively reexamined." Accordingly, as *Merrill Lynch* states, *"no comparable legislative approval or acquiescence exists for the Rule 10b-5 remedy," id.* at 1845 n.88.

Merrill Lynch also considered as relevant "the traditional role of the States in providing relief," *id.* at 1839 n. 60, and held that "there is no basis for believing that state law will afford an adequate remedy against an exchange" and require "exchanges to police the trading activities in the markets that they are authorized by statute to regulate." 102 S.Ct. at 1847. In contrast, Rule 10b-5 actions against accountants and other professionals, not covered by express provisions of the federal securities laws, are essentially cases where the federal securities laws "are wholly inappropriate and wide of the Congressional mark" and where there is ingrafted "upon the misplaced federal securities law claim a state law claim that, but for the federal gloss, should have been litigated in the state courts," *Ryan* v. *J. Walter Thompson Co.*, 453 F.2d 444, 445 (2d Cir. 1981), *cert. denied*, 406 U.S. 906 (1972).

Also, the implied remedy in *Merrill Lynch* was not based on a section which could become operative only at a later date, when the Commodity Futures Trading Commission issued a rule which in effect would create the implied remedy and which could later cease to exist if the agency rescinded the rule.

POINT IV

Policy considerations dictate reducing the burden on the lower federal courts of the escalating recourse to Rule 10b-5 and § 17(a) damage suits.

Assuming that the Acts and their legislative history do not "offer conclusive guidance" as to whether Congress intended to imply a private civil remedy, this Court will consider "policy considerations." *Blue Chip Stamps*, 421 U.S. at 737. This Court has long been concerned with the growth of Rule 10b-5 "from little more than a legislative acorn" to "a judicial oak," *id.* at 737.

The dissent in *Merrill Lynch* states as a policy consideration that " 'we should not condone the implication of any private right of action from a federal statute absent the most compelling evidence that Congress in fact intended such an action to exist'," 102 S.Ct. at 1855 (quoting *Cannon* v. *University of Chicago, supra*, 441 U.S. at 749) (Powell, J., dissenting). Footnote 17 then states:

> There can be little doubt that failure to adhere to this standard will encourage the discovery of private causes of action of which Congress never dreamed. The escalating recourse to damages suits has placed a severe and growing burden on the lower federal courts .... It is time federal courts discontinued the speculative creation of damages liability where the legislative branch has chosen to remain silent.

The majority, which did not differ with such policy consideration, found, with respect to the statute there involved, that Congress had "comprehensively reexamined" the entire statute, with knowledge of the existence of the implied remedy, and "evidenced an affirmative intent to preserve this enforcement tool," while stressing, in con-

trast, that "*no comparable legislative approval or acquiescence exists for the Rule 10b-5 remedy.*" *Id.* at 1845 n.88.

If the issue of an implied private civil remedy under § 10(b) and Rule 10b-5 is to be determined on the basis of this Court's decisions over the last five years, this would require a holding that such an implied remedy does not exist because Congress did not intend such a remedy in 1934 when the statute was enacted. The "policy consideration," therefore, becomes whether—where this Court has simply "acquiesced" with "virtually no discussion" in lower federal court decisions which found or assumed a private civil remedy not intended by Congress—the clear Congressional intent is to be superseded by a judicially created remedy merely because such remedy is of long standing.

Redington made clear that "[t]he ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law," 442 U.S. at 578. The "policy considerations" are whether, absent the requisite congressional intent, this Court should sustain a judicially created remedy because lower federal courts had felt that they could "improve upon the statutory scheme that Congress enacted into law." If it is so clear, as we submit it is, that Congress did not intend to create a private civil remedy under § 10(b) and also that the draftsman of Rule 10b-5 did not intend to create a private civil remedy under the Rule, must such a remedy nevertheless be sustained simply because a little more than eleven years ago, in *Superintendent,* 404 U.S. at 13 n.9, this Court "acquiesced" in its existence with virtually no discussion?* If, as held in

* *Superintendent* was not, as already noted, a suit covered by a remedy expressly provided in the 1934 Act. The securities involved were United States Government bonds; there was no claim of misstatement or omission as to such securities; and the case, of a nature

(footnote continued on next page)

Transamerica, 444 U.S. at 24, "[t]he *dispositive question* remains whether Congress intended to create any such remedy," does the question cease to be "dispositive," and is Congressional intent to be superseded because this Court has previouly acquiesced in such lower courts' erroneous conception of the applicable standard?

However, if this Court should conclude that its mere acquiescence eleven years ago in lower court decisions should prevail over clear Congressional intent, then such conclusion would have no application to the narrower issue whether an implied remedy exists under § 10(b) or § 17(a) for purchasers of securities who have an express remedy under § 11 of the 1933 Act. This Court has at no time acquiesced in a specific decision that, where the Acts provide express remedies, a plaintiff who could avail himself of such express remedies may nevertheless sue under § 10(b), Rule 10b-5 and § 17(a) and thereby finesse the restrictions placed on the express remedies. As already noted, this Court has had "no occasion to pass" on "the question of whether an implied action under § 10(b) of the 1934 Act and Rule 10b-5 will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act," *Blue Chip Stamps*, 421 U.S. at 752 n.15.

Also, a conclusion that this Court must now sanction a practice, contrary to Congressional intent, because of its prior acquiescence, would not apply to the issue whether there is an implied remedy under § 17(a) of the 1933 Act. For there, as has been noted, a significant number of lower

---

normally brought in state court, was the typical "boot-strap" purchase of control of a corporation by using its assets to buy the controlling stock. *Superintendent* has been described as having "pushed the perimiters rather far where securities are involved." *IIT* v. *Vencap, Ltd.*, 519 F.2d 1001, 1014 n.26 (2d Cir. 1975).

courts have held that such a remedy does not exist. And this Court has expressed "no opinion on whether § 17(a) in light of the express civil remedies of the 1933 Act gives rise to an implied cause of action." *Id.* at 734 n.6.

If this Court is concerned that a holding that there is no implied private civil remedy under § 17(a), § 10(b) or Rule 10b-5 would have drastic consequences, it may be mindful of the occasions when it made far more drastic changes in existing law, which had been in effect for periods far longer than the years since this Court in *Superintendent* first "acquiesced" in the existence of a private civil remedy under Rule 10b-5.

What § 10(b), the "catchall clause," catches are those cases whereby the "federal judiciary is increasingly burdened by attempts to bring claims under state law before the federal courts in the guise of Rule 10b-5 actions," *Billard v. Rockwell International Corp.*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,290 at 97,018 (S.D.N.Y. 1980).

Were this Court to require adherence to Congressional intent, then plaintiffs will simply be required to assert their state court claims in the state court,* and to assert their federal securities claims under the sections of the Acts which expressly authorize such claims and provide specific remedies therefor.

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* Since *Hochfelder* reversed the Seventh Circuit and held that a third party who relied on an accountant's audit of its client could not sue for negligence but only for fraud, the Rule 10b-5 principle is essentially no different from state law. *See Ultramares Corp.* v. *Touche, supra,* which this Court quoted with approval in *Blue Chip Stamps, supra,* 421 U.S. at 748, and in *Hochfelder, supra,* 425 U.S. at 214-15 n. 33. *Ultramares* was recently reaffirmed in *Dworman* v. *Lee,* 83 A.D. 2d 507, 441 N.Y.S.2d 90 (1st Dep't 1981), *aff'd mem.,* No. 304, N.Y.L.J. June 10, 1982, p. 4, col. 1 (N.Y. Ct. App., June 8, 1982), "for the reasons stated" in the Appellate Division's decision.

Conclusion

It is respectfully submitted that this Court should hold that there is no implied private civil remedy under § 10(b), Rule 10b-5 or § 17(a), particularly where the claim asserted could have been asserted under express civil remedies provided for in the Acts.

Dated: June 18, 1982

Respectfully submitted,

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Nos. 81-680, 81-1076

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

HERMAN & MACLEAN,

Petitioner,

v.

RALPH E. HUDDLESTON, *et al.*,

Respondents.

and

RALPH E. HUDDLESTON, *et al.*,

Petitioners,

v.

HERMAN & MACLEAN, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF SECURITIES INDUSTRY ASSOCIATION, *AMICUS CURIAE*

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IN THE

Supreme Court of the United States

October Term, 1981

Nos. 81-680, 81-1076

HERMAN & MACLEAN,

Petitioner in 81-680,
Respondent in 81-1076,

v.

RALPH E. HUDDLESTON, *et al.*,

Respondents in 81-680,
Petitioners in 81-1076.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF SECURITIES INDUSTRY ASSOCIATION, *AMICUS CURIAE*

Pursuant to Rule 36.2 of this Court and with the consent of the parties, the Securities Industry Association ("SIA") submits this brief as *amicus curiae* in support of the petitioner in No. 81-680 and the respondents in No. 81-1076.

The SIA was formed in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Bankers Association of America; it represents approximately 500 brokers and dealers responsible for over 90 percent of the Nation's investment banking and securities brokerage business. The SIA is generally recognized as the principal public spokesman for the securities industry, to which the two questions before the Court are of vital importance.

Statement of the Case

This case arose from an initial public offering of securities by a newly organized company, Texas International Speedway ("TIS"), which thereby raised capital for the construction of an automobile racetrack. The offering was registered pursuant to § 5 of the 1933 Act and was fully subscribed in the amount of approximately $4.4 million on the offering date, October 30, 1969. Thirteen months later, on November 30, 1970, TIS filed for bankruptcy (A2).[1]

In August 1972, almost two years after bankruptcy, the plaintiffs sued on behalf of all purchasers in the 1969 offering, claiming that the registration statement and prospectus contained untrue and misleading statements, particularly an underestimate by approximately $500,000 of the ultimate cost of constructing the racetrack. Plaintiffs sued virtually everyone associated with the offering except the issuer—the former directors and officers of the issuer, the managing underwriter (Ladenburg, Thalmann & Co.) and other members of the underwriting syndicate, the underwriters' attorneys, the engineers who had "expertized" the construction cost estimates, the accountants who had certified financial statements in the registration statement (Herman & MacLean), and the contractor for construction for the racetrack (A2, 3; 17a-33a).

Plaintiffs did not sue under § 11 of the 1933 Act, in which Congress expressly prescribed the "civil liabilities on account of [a] false registration statement," *see* 48 Stat. 82, but under § 10(b) of the 1934 Act and § 17(a) of the 1933 Act, which include no provisions for civil liability

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[1] Citations in the form "—a" are to the joint appendix; citations in the form of "A—," "B—," et cetera, are to the appendix to the petition for certiorari in No. 81-680.

The text of Sections 5, 11, 12, 13 and 17 of the Securities Act of 1933 (the "1933 Act"), 48 Stat. 77, 82, 84, as amended, 15 U.S.C. §§ 77e, 77k, 77l, 77m, 77q (1976), and Sections 9, 10, 18 and 28(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 48 Stat. 889-91, 897, 903, as amended in the case of § 18, 15 U.S.C. §§ 78k, 78j, 78r, 78bb(a) (1976), and other statutory provisions are set forth in the statutory appendix to the Brief of Herman & MacLean.

(19a). Plaintiffs apparently sought to avoid the many limitations on liability that Congress specified with respect to § 11, including a one-year statute of limitations that would likely have barred their claim.

During discovery, the underwriters, their counsel and the contractor settled the claims against them for $325,000 (A3). The trial against the remaining defendants commenced in 1979, ten years after the effective date of the registration statement (C1). At trial, plaintiffs emphasized the special "duty of due diligence" claimed to be owed by the defendants,[2] and the instructions to the jury suggested a basis for liability other than intentional misconduct.[3]

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[2] The last day of plaintiffs' case was devoted to asking questions about "a standard in the underwriting industry with respect to what was expected of experts and directors in connection with the preparation of Registration Statements." (Tr. 1259). Counsel for defendants objected, on the basis that the questioning was "extraordinarily misleading" since "the standard of proof [under § 11] is entirely different than it is in a 10(b)(5) proceeding" (Tr. 1262), to which plaintiffs' counsel responded "scienter is required with Section 17(a) but not necessarily scienter of a manipulative deceptive type that is the center of recklessness . . ." (Tr. 1265); *see also* Tr. 1315 (suggesting that a failure to exercise due diligence can give rise to § 10(b) liability).

The district court overruled defendants' objections (Tr. 1294-95) and plaintiffs' final live witness thereupon emphasized, repeatedly, the nature and importance of the "standard of due diligence." *See* Tr. 1295:

> "standards of due diligence . . . were standards which required a person who was associated with the preparation of a Registration Statement to take whatever procedures were required to ascertain that the disclosures which he had made in the document were to the—to his very best ability accurate and correct."

See Tr. 1330; *see generally* Tr. 1295-1334. The court of appeals considered this testimony to be harmless because, although it encompassed the § 11 duties of accountants and others in the registration process, it "primarily concerned a party [the engineers] in whose favor judgment was rendered" (A30 n.29).

[3] The instructions included language that "not merely simple or even inexcusable negligence but extreme departure from the standards of ordinary care" was required for "reckless" *scienter*, which the court described as "conduct which is highly unreasonable"

(footnote continued on following page)

The jury rendered verdicts against the accountants, as well as two corporate officers and directors, because they "failed to disclose" posible cost overruns "with reckless disregard for the truth" (A4, n.2). The engineering firm that had "expertized" the cost projections was found not liable (C7; 170a). The district court entered judgment for "rescissional damages" of approximately $3,000,000 (C4, A35).

The court of appeals affirmed the district court's holding that plaintiffs had an implied right of action for damages under § 10(b) of the 1934 Act for a misleading 1933 Act prospectus, notwithstanding the express provisions of § 11 (A5-11).[4] To justify this result, the court relied on *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 786-87 (2d Cir. 1951), which held:

> "We think that when, to conduct actionable under § 11 of the 1933 Act, there is added the ingredient of fraud, then that conduct becomes actionable under § 10(b) of the 1934 Act . . . ."

Both *Fischman* and the decision below postulated a need for an implied remedy because § 11 provides a remedy only to purchasers of the registered securities and not to others in the market (A10, 188 F.2d at 786-87). The court below feared that issuers might deliberately exploit this "limitation" and use a prospectus to perpetrate a massive fraud on persons other than purchasers of the registered securities, while relying on § 11 to insulate themselves from liability to their victims (A10).[5] This case, however, involved no such

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(footnote continued from preceding page)

(149a). The court rejected the charge requested by defendants that "if you find that the defendants had an honest belief that the statements in the prospectus for which they were responsible were true, whether or not that belief was reasonably based, you must find for the defendants" (132a).

[4] The court of appeals expressed no view on the availability of an implied private remedy under § 17(a) of the 1933 Act.

[5] In such a scheme, as hypothesized in *Fischman*, insiders might use misstatements in a prospectus as a ploy to drive up the price of

(footnote continued on following page)

scheme, and the court of appeals recognized that, unlike the plaintiffs in *Fischman*, plaintiffs here were members of the class that Congress afforded a right of action under § 11. Without discussion, the court concluded that "the *Fischman* rationale is nevertheless applicable here" (A7, n.5).

The court of appeals also affirmed the district court's charge defining *scienter* as "highly unreasonable" behavior (149a, A16); referring to what it termed a "standard of care" imposed by § 10(b), the court of appeals found sufficient evidence to support a jury finding against the defendants on that issue (A18-19). The court remanded for retrial, however, on the basis, among others, that the district court had erred in instructing the jury that the *scienter* element of § 10(b) could be proven by a "mere preponderance of the evidence" rather than, as at common law and for other kinds of statutory fraud, by "clear and convincing evidence" (A16-17).

Summary of Argument

Congress nowhere indicated that it intended any private right of action under § 10(b), and whether or not the Court continues to allow such actions in other situations, § 11's comprehensive remedial scheme for misstatements in a registration statement precludes the implication of rights under § 10(b) or § 17(a) for the same conduct.

Further, § 10(b) as applied nullifies § 11. Lower courts, as here, often allow claimants under § 10(b) to utilize the special liability provisions of § 11 while ignoring the counterbalancing limitations prescribed by Congress in the same

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the issuer's outstanding securities, to the personal benefit of the insiders. The opinion in *Fischman* did not note that Congress has provided an express remedy, in § 12(2) of the 1933 Act, for all misstatements in the sale of securities. The *Fischman* court acknowledged the possible availability of express remedies in §§ 9 and 18 of the 1934 Act but did not reconcile their availability with the implication of a remedy under § 10(b). 188 F.2d at 788.

provisions. The result is a mutation that not only contravenes the legislative scheme, but attributes to Congress intentional futility, since the limitations on the special liability imposed by the 1933 Act were mandated by Congress as Title II of the same 1934 Act that created § 10(b).

The "additional element of fraud" that courts have viewed as so significant in § 10(b) implied actions is nowhere identified in the legislation or its history as a means of distinguishing § 11. To the contrary, the purpose of § 11 was to encompass all false statements in a prospectus, whether fraudulent or non-fraudulent. Nor is there any indication anywhere that Congress intended to have the courts dispense with important aspects of its carefully drafted legislation through a trade-off for an "additional element" of the courts' devising. Finally, review of policy considerations—particularly the alleged "need" for implied actions—leads, emphatically, to a conclusion contrary to that reached by the court below.

If and to the extent private actions are permitted under § 10(b), on a prospectus or otherwise, to avoid subverting the express intent of Congress, any such implied actions should be governed by the important procedural safeguards Congress prescribed for express private rights of action created in the 1933 and 1934 Acts—a short (one-year/three-year) statute of limitations, a bond for costs and attorneys' fees and, for underwriters, a limitation on maximum damages.

Finally, in any private actions that might be allowed under § 10(b), the requisite state of mind must be wrongful intent, not something "more than simple negligence," and it must be proved, as at common law and in other statutory fraud, by clear and convincing evidence.

ARGUMENT

I.

Courts May Not Devise Remedies of Their Own for a Misleading Prospectus When Congress Has Expressly Prescribed Certain Remedies With Specificity.

In determining whether to imply a private right of action from a federal statute, "[t]he key to the inquiry is the intent of the Legislature." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 102 S.Ct. 1825, 1839 (1982) ("*Merrill Lynch*"), quoting *Middlesex County Sewerage Auth.* v. *National Sea Clammers Ass'n*, 453 U.S. 1, 13 (1981) ("*Sea Clammers*"); *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 24 (1979) ("*TAMA*"); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 575 (1979).

The search for Congress's intent may involve consideration of several factors,[6] but "when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies." *National Railroad Passenger Corp.* v. *National Ass'n of Railroad Passengers*, 414 U.S. 453, 458 (1974) ("*Amtrak*"). As the Court stated in *Northwest Airlines, Inc.* v. *Transport Workers Union*, 451 U.S. 77, 97 (1981) (citations omitted):

> "In almost any statutory scheme, there may be a need for judicial interpretation of ambiguous or incomplete provisions. But the authority to con-

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[6] Courts have attempted to discern congressional intent by considering whether the implied action is consistent with the overall legislative scheme, by review of the legislative history, by identifyng the class for whose benefit the statute was enacted, and by study of the traditional role of state law remedies. *Merrill Lynch*, 102 S.Ct. at 1839 n. 60; *Cort* v. *Ash*, 422 U.S. 66, 78 (1975). Once the intent of Congress is discerned, by whatever hallmark, the inquiry is ended. *TAMA*, 444 U.S. at 24:

> "The dispositive question remains whether Congress intended to create any such remedy. Having answered that question in the negative, our inquiry is at an end."

> strue a statute is fundamentally different from the authority to fashion a new rule or to provide a new remedy which Congress has decided not to adopt. . . . The presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement. . . . The judiciary may not, in the face of such comprehensive legislative schemes, fashion new remedies that might upset carefully considered legislative programs."

Congress provided express private remedies in the "interrelated . . . federal regulatory scheme" of the 1933 and 1934 Acts, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 206 (1976), including, in §§ 11 and 12 of the 1933 Act, "express civil remedies for misrepresentations and omissions in registration statements and prospectuses," *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 753 (1975). The Court has frequently held up § 11 as a paradigm of exactitude, *see Ernst & Ernst*, 425 U.S. at 207-11; *Blue Chip Stamps*, 421 U.S. at 730, 736, 753-54, and has also cited it for the proposition that Congress in providing express remedies intended to preclude implication of others:

> "Congress provided an express damages remedy for misrepresentations contained in an underwriter's registration statement in § 11(a) of the Securities Act of 1933 . . . . 'Obviously, then, when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly.' "

TAMA, 444 U.S. at 21 (citations omitted) (quoting *Touche Ross*, 442 U.S. at 572). *See also Blue Chip Stamps*, 421 U.S. at 730, 753-54.

By contrast, Congress nowhere intimated—expressly, impliedly or otherwise—that it intended any private right of action under § 10(b) of the 1934 Act, and this Court has so recognized. *Blue Chip Stamps*, 421 U.S. at 729-30. Section 10(b) by its terms authorizes regulation rather than

private remedies—"Regulation of the Use of Manipulative and Deceptive Devices" is its caption. 48 Stat. 891.

Similarly, Congress nowhere suggested a need for separate private remedies under § 17(a) of the 1933 Act, which prohibits all "fraudulent transactions" in the offer or sale of securities, and Congress provided none. "Sections 11 and 12 create and define the civil liabilities imposed by the act." H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933). Commissioner Landis stated unequivocally regarding § 17 that "a reading of this section in the light of the entire Act leaves no doubt but that violations of its provisions give rise only to a liability to be restrained by injunctive action or, if wilfully done, to a liability to be punished criminally." Landis, *Liability Sections of Securities Act Authoritatively Discussed*, 18 AM. ACCT. 330, 331 (1933).[7]

Because Congress has provided express rights of action and has not indicated that others should be implied, the Court is "compelled to conclude that Congress provided precisely the remedies it considered appropriate." *Sea Clammers*, 453 U.S. at 15. Put differently, the remedy provided in § 11 for misleading prospectuses " 'includes the negative' " of any different remedies, or affecting different persons, that might be sought to be implied. *Amtrak*, 414 U.S. at 458. "This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.*" *Id.*

The will of Congress in enacting the comprehensive remedial scheme of the 1933 Act is clear, and every canon of statutory construction precludes implication of new remedies for the same conduct. Further inquiry is inappropriate.

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[7] *See also* 78 Cong. Rec. 8711-12 (1934) (concerning proposed additions to § 17): "No civil liability attaches for any violation thereof." Twenty years later, this was still Congress's view. *See* H.R. REP. No. 1542, 83d Cong., 2d Sess. (1954) at 26: "Section 17 is the general fraud provision under which criminal and injunctive actions are brought . . . ." Because the discussion of an implied remedy under § 10(b) is equally applicable to one under § 17(a), we do not further discuss § 17(a) as a separate question.

II.

An Implied Action on a Misleading Prospectus Does Not Further the Intent of Congress, But Rather Nullifies It.

The court below failed to address the question of judicial implication of implied remedies on a prospectus within the analytical framework required by this Court and set forth above. Instead, it perceived a need for an implied remedy because, otherwise, persons injured by a misleading prospectus and not entitled to sue under § 11—*i.e.*, persons who did not purchase any of the registered securities—might be left without a federal remedy. It considered that the additional element of *scienter* was sufficient justification for allowing this alternative right of action on a misleading prospectus.

Such arguments "concerning the 'necessity' of implying a private remedy . . . have little relevance" when, as here, "[t]he question whether Congress, either expressly or by implication, intended to create a private right of action, has been definitely answered in the negative." *Touche Ross & Co.* v. *Redington*, 442 U.S. at 575-76; *see Aaron* v. *SEC*, 446 U.S. 680, 700 n.19 (1980).

Moreover, scrutiny of those arguments, in light of the legislative history and the practical consequences of implied actions, demonstrates the wisdom of the Court's emphasis that the judiciary must give effect to the Congressional scheme rather than second-guessing Congress's judgments. As we next discuss in detail:

> (a) The legislative history of the 1933 Act and the 1934 amendments thereto reveal uncommon concern by Congress to delineate precisely the obligations of those connected with the new issue process. The history also confirms that the express remedies provided encompass all misstatements, whether fraudulent, negligent or excusable (pages 11-15).

(b) The history of the 1934 Act, by contrast, reveals no intention for § 10(b) to give rise to any private action, much less an implied private action for fraudulent misstatements in a 1933 Act prospectus. *Fischman* and decisions following it pay no heed to the statutory scheme (pages 16-20).

(c) Judicial postulation of a "need" for an implied remedy to protect persons to whom Congress granted no remedy in § 11 amounts to a rejection of Congress's judgment to exclude such persons. The "need," moreover, is illusory. Congress in the 1933 and 1934 Acts afforded remedies, with the restrictions it thought appropriate, to all purchasers and sellers of securities (pages 21-23).

(d) The existence of an "alternative" implied remedy for a misleading prospectus under § 10(b) has the practical effect of nullifying the careful balance struck by Congress in § 11. Lower courts often, as here, consider the conduct of underwriters and accountants by reference to the statutory "duty of due diligence" created by § 11, without enforcing any of the offsetting limitations and protections (pages 23-25).

A. Section 11 and the 1933 Act

1. *The 1933 Act as Originally Enacted.* The 1933 Act was an adaptation of the English Companies Act, itself "the culmination of almost a hundred years of struggling with this problem abroad." Landis, *supra* at 330. At the end of extensive hearings and debate, Senator Greenwood commented that "I never have read a bill that appeared to be more carefully drawn." 77 CONG. REC. 2913 (1933). The act, in sum, required issuers to prepare detailed registration statements and prospectuses for new securities issues, and specified civil and criminal liabilities for misstatements therein. *See generally Ernst & Ernst*, 425 U.S. at 207-211; *Blue Chip Stamps*, 421 U.S. at 752-54.

The legislated private remedies departed radically from the common law and allowed recovery along a broadened

rescission theory. With respect to the issuer, Congress imposed in § 11 virtual absolute liability for material misstatements, on the theory that the issuer should not be permitted to retain the fruits derived from its misstatements. *See Comment, Civil Liability for Misstatements in Documents Filed Under Securities Act and Securities Exchange Act,* 44 YALE L.J. 456, 458 (1935). The issuer was relieved of liability only if it proved a particular purchaser knew of the misstatement.

For underwriters, directors and officers of the issuer, and experts who prepared or certified portions of the registration statement, § 11 imposed the same absolute liability, subject only to a statutory defense of reasonable belief in the truth of the statements made after reasonable investigation. By eliminating the common law requirement of fraud and creating a statutory defense of "due diligence," Congress threw "upon the originator of securities a duty of competence, as well as innocence." H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933).[8]

It was § 11's "assault on the citadel of privity" that marked "its greatest departure from precedent." 3 L. Loss, SECURITIES REGULATION 1731 (2d ed. 1961). All purchasers of the registered securities, whether they bought on the initial offering or later in the market, were given a right of action. Purchasers were also relieved of having to meet any of the common law requirements of reliance and of proving that the misrepresentation was addressed to them. *See* Schulman, *Civil Liability and the Securities Act,* 43 YALE L.J. 227, 248-49 (1933).[9]

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[8] Courts and counsel commonly refer to the "duty of due diligence," although by statute "due diligence" is a defense to the otherwise absolute liability imposed by § 11, rather than an affirmative duty.

[9] Congress created an additional private right of action in § 12, which retained a requirement resembling common-law privity. Section 12(2) allowed recovery for misstatements, whether or not in connection with any new issue, and again without the necessity to show fraud or reliance. *Id.* at 243-47.

Congress considered bills that required fraud as an element of a private claim,[10] and distinguished fraudulent conduct in provisions of the act where it thought appropriate, particularly in § 17. Section 11, however, encompassed all "civil liabilities on account of [a] false registration statement," 48 Stat. 82, and distinguished fraudulent statements only in the availability of contribution: § 11(f) provided a right of contribution among defendants except where one "person who has become liable was, and the other was not, guilty of fraudulent misrepresentation." In its private remedial scheme, Congress wanted to shift the focus away from defendants' "state of knowledge" and to minimize where possible disputes on "failure to exercise due care." H.R. REP. No. 85 at 9; *see* SEN. REP. No. 1455, 73d Cong., 2d Sess. 101 (1934):

> "The Securities Act, to prevent a recurrence of these gross frauds, promulgates a new standard of conduct for investment bankers in the primary marketing of securities, requiirng [sic] a complete, full, and accurate disclosure of all relevant facts."

The express private remedies were intended to be the exclusive private remedies. *See* H.R. REP. No. 85, at 9-10:

> "Sections 11 and 12 create and define the civil liabilities imposed by the act. . . .
>
> . . . .
>
> "To impose a greater responsibility, apart from constitutional doubts, would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public."

In sum, §§ 11 and 12 embody "[w]hat liability there exists for damages for violation of the Act," § 11 being "the

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[10] For example, H.R. 4314 and S. 875 allowed recovery against the signers of the misleading registration statement and also against "any vendor knowing of such falsity." In another bill, the Senate proposed insurers' liability on the officers of the issuer, but no liability for underwriters and experts. *See* H.R. CONF. REP. No. 152, 73d Cong., 1st Sess. 26 (1933).

section that imposes liabilities consequent upon misstatements in a registration statement." Landis, *supra* at 336. *See* H.R. REP. No. 1542, 83d Cong., 2d Sess. 14 (1954).

To counterbalance somewhat the liability imposed in § 11, Congress provided a right of contribution, as discussed above, and also limited maximum damages to the price actually paid for the security. Congress deliberately allowed *"in terrorem"* recovery, however, for depreciation in market value attributable to causes unrelated to the misstatement. *See generally* Landis, *supra* at 333.

2. *The 1934 Act Amendments to the 1933 Act.* After enactment of the 1933 Act, Congress began to question the balance it had struck as imposing too great a burden for misstatements in a registration statement. Senator Byrnes, a member of the conference committee on the 1934 Act, described the general concern over the liabilities imposed by the 1933 Act, particularly on underwriters and individuals:

> "The provisions of the Securities Act of 1933 which have caused the greatest complaint are those as to the civil liability of underwriters and of the officers and directors of corporations on account of false registration statements filed by corporations."

78 CONG. REC. 10185 (1934); *see also* 78 CONG. REC. 8576 (1934) (Senator Gore); *Id.* (Senator Reynolds); 78 CONG. REC. 8708 (1934) (Senator Thomas, objecting to the "severity of the penal clauses and the damage liability"); 78 CONG. REC. 10266 (1934) (Congressman Rayburn: "There has been a question ever since the adoption of the Securities Act of 1933 with reference to the underwriter").

Senator Fletcher, the Chairman of the Senate Banking and Currency Committee, sponsored amendments to the 1933 Act to met these concerns. *See* 78 CONG. REC. 8667-69 (1934). These amendments

> (a) required plaintiffs in certain circumstances to prove reliance (§ 11(a));

(b) allowed all defendants to avoid damages to the extent not directly attributable to the misstatement in the prospectus (§ 11(e));

(c) limited the maximum exposure of an individual underwriter to the amount it actually underwrote unless the underwriter received special benefits from the issuer (§ 11(e));

(d) provided, "as a defense against blackmail suits," 78 CONG. REC. 8669, the authority to require a bond for costs (§ 11(e)); and

(e) shortened the limitations period from two-years/ten-years to one-year/three-years (§ 13).[11]

Commissioner Landis said that the purpose and effect of the "substantial" amendments to § 11 were to "very materially modify and restrict the liability of various persons in connection with the registration statement." 78 CONG. REC. 8715 (1934). Senator Fletcher described the amendments to § 11(e) as "the most important of all." 78 CONG. REC. 8669 (1934).

In conference with the House of Representatives, Senator Fletcher's amendments were modified so as further to limit the exposure of an individual underwriter on a misleading prospectus. *See* H.R. CONF. REP. No. 1838, 73d Cong., 2d Sess. 42 (1934).[12] As modified, the amendments were passed as § 206 of Title II of the 1934 Act, 48 Stat. 907-08.

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[11] Congress also eased the standard case required in § 11(c) of underwriters and others from that of one "occupying a fiduciary relationship" to that of "a prudent man in the management of his own property." *See* Hanna, *The Securities Exchange Act of 1934*, 23 CALIF. L. REV. 1, 7 ("presumably everywhere the conduct of a prudent man who acts for himself will be regarded more charitably than that of the trustee for widows and orphans").

[12] The House modification made clear that an underwriter's exposure was not simply limited to the amount underwritten, but to the amount the individual underwriter actually "distributed to the public." The House also clarified the special benefits exception to this limitation by specifying that the benefits had to have been received by the underwriter "knowingly" and out-of-proportion to any similar benefits received by other underwriters. *Id.*

B. Section 10(b) and the 1934 Act

1. *The Legislative Scheme.* In contrast to the comprehensive remedial scheme set forth by Congress in § 11 for "civil liabilities on account of [a] false registration statement," the legislative history of the 1934 Act is "bereft" of any indication that Congress intended any private remedy under § 10(b). *See Aaron* v. *SEC*, 446 U.S. at 690; *Ernst & Ernst*, 425 U.S. at 201.

The SEC is itself without authority to change Congress's judgment in this regard, but its promulgation of Rule 10b-5 similarly reveals no arguable intent to expand private rights under the Act. Rule 10b-5 was literally written and promulgated in one day, in 1942, to provide the SEC a basis on which to obtain injunctions against fraudulent "purchases" not thought to be proscribed by § 17(a) of the 1933 Act, which applies only to the "offer or sale" of securities.[13] *See Ernst & Ernst*, 425 U.S. at 212-13 n.32; 3 L. Loss, *supra* at 1759.

Congress did not intend "criminal penalties as the sole sanction" for violations of the 1934 Act, and expressly provided civil remedies to purchasers and sellers of securities where it thought appropriate, *i.e.*, in §§ 9 and 18, 15 U.S.C. §§ 78i, 78r (1976). Thus, in its comprehensive analysis of the Act, Senate Report No. 792 states, under the heading "Civil Liabilities":

> "[I]f an investor has suffered loss by reason of illicit practices, it is equitable that he should be allowed to recover damages from the guilty party. With these considerations in view, the bill provides that any person who unlawfully manipulates the price of a security [§ 9(a) (1), (2), (3), (5), (6);

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[13] *See Ernst & Ernst*, 425 U.S. at 212-13 n.32. The SEC incorporated much of the language of § 17(a) word-for-word into Rule 10b-5. The principal distinction is that the rule contains the words "purchase or sale" in place of "offer or sale." *See Aaron* v. *SEC*, 446 U.S. at 687-88 (1980). Thus, Commissioner Landis' comments about § 17(a), *see* page 9, *supra*, are equally applicable to § 10(b) as given effect by Rule 10b-5.

> § 9(b); § 9(c)], or who induces transactions in a security by means of false or misleading statements [§ 9(a)(4)], or who makes a false or misleading statement in the report of a corporation [§ 18(a)], shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement."

SEN. REP. No. 792, 73d Cong., 2d Sess. 12-13 (1934). The detailed provisions of §§ 9 and 18 would be entirely surplusage and Congress's drafting, consideration and enactment of them a senseless charade had Congress intended the courts to add everything they provide, and more, to § 10(b).[14]

While the Court is not here presented with the issue of reconciling implied actions under § 10(b) with the express

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[14] Section 18(a) provides both a standard of liability and a private damages remedy. The right to sue for damages for violation of § 9(a), (b) and (c) is conferred by § 9(e). While the coverage of § 9 is limited to securites "registered on a national securities exchange," § 18 applies to all securities of issuers registered under the 1934 Act. The two sections provide express private remedies for many of the acts that lower courts now allow to be litigated under § 10(b). Both sections, however, are subject to certain express limitations not found in implied actions under § 10(b), including the same one-year/three-year limitations period as in the 1933 Act and a provision for costs "to discourage blackmail suits." Congress also provided other "restrictions," such as requiring in § 18 that plaintiff prove actual causation between the misstatement and change in price. That is Congress's judgment, however, and Congress has rejected efforts to ease the burden. *See* 3 L. Loss, *supra* at 1753 (describing Congress's rejection in 1941 of a proposal to amend § 18).

The only other section of the 1934 Act allowing private actions, § 16(b), does not provide a damages remedy to purchasers or sellers of securities but allows derivative suits to recover profits from "insider trading." The limitations period is two years.

Section 29(b), 48 Stat. 903, as amended, 15 U.S.C. § 78cc(b) (1976), affords a defense to actions seeking to enforce executory contracts that violate the 1934 Act, and may authorize rescission in certain circumstances, *see Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 386-88 (1970), provided that rescission does not "provide by indirection the equivalent of a private damages remedy that . . . Congress did not confer," *TAMA*, 444 U.S. at 24 n.14 (construing § 215 of the Investment Advisor's Act). The proviso to § 29(b),

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rights of action provided by the 1934 Act, *see Touche Ross*, 442 U.S. at 572-73; *Ernst & Ernst*, 425 U.S. at 211 n.31, the specification of those express rights of action precludes any argument that Congress intended some broader scope for the 1934 Act's regulatory provisions than it did for those in the 1933 Act.

2. *Implied Private Rights under § 10(b).* A private right under § 10(b) was first implied in 1946, in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), where the court looked to Congress's intent only to see "whether an intention can be implied to deny a remedy." *Kardon*, however, involved transactions between plaintiffs and insiders that would have been actionable under traditional criteria, and seemed only to afford a federal forum. *See also Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F. Supp. 954 (N.D. Ill. 1952). The early courts balked at claims brought by anonymous purchasers and sellers against insiders with whom there were no traceable dealings. *Joseph* v. *Farnsworth Radio & Television Corp.*, 99 F. Supp. 701, 706 (S.D.N.Y. 1951) (must be "a semblance of privity between vendor and purchaser"), *aff'd per curiam*, 198 F.2d 883 (2d Cir. 1952).

Soon after *Kardon*, plaintiffs began bringing actions under § 10(b) for conduct covered by express remedies, for the purpose of avoiding the limitations of those remedies. *See Osborne* v. *Mallory*, 86 F. Supp. 869, 879 (S.D.N.Y. 1949). In the first case to address a claim under § 10(b) on a 1933 Act prospectus, *Montague* v. *Electronic Corp. of America*, 76 F. Supp. 933 (S.D.N.Y. 1948), plaintiff sought to avoid the provisions in § 11(e) with respect to undertakings for costs. Emphasizing that § 10 and 11 must

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enacted with the 1938 amendments to expand the regulation of over-the-counter securities, 52 Stat. 1076, appears expressly to authorize a rescission claim under § 15(c)(1), with a one-year/three-year statute of limitat[illegible] Whatever the ultimate function of § 29(b), *see Blue Chip Stamps*, 421 U.S. at 735, it clearly covers only contracts between parties and therefore requires privity. *See* 3 L. Loss, *supra* at 1754-55.

"stand together in the same statutory scheme," the district court held that § 10(b) was "clearly not intended to supplant Section 11 of the 1933 Act," and rejected the very proposition here before the Court. *Id.* at 936. *Kardon* was distinguished as not involving "untrue statements and omissions in the Registration Statement." *Id.* Later in 1948, without deciding whether a claim on a prospectus could be brought under § 10(b), Judge Kirkpatrick, the author of *Kardon,* rejected plaintiffs' efforts to avoid 1933 Act limitations:

> "It cannot be supposed that Congress intended to abolish these regulations and limitations [of §§ 11 and 12 of the 1933 Act] when it enacted Sec. 10 of the Act of 1934. By any reasonable rule of statutory interpretation, it would require either an express repeal or an implication of repeal so strong as to be inescapable. The two Acts are unquestionably in pari materia and must be construed together to make a consistent whole. Looking at them as one statute it is simply not possible that Congress, having prescribed in elaborate detail procedural requirements which must be fulfilled in order to enforce civil liability attaching to a carefully defined type of violation, would have casually nullified them all in a later section."

Rosenberg v. *Globe Aircraft Corp.*, 80 F. Supp. 123, 124 (E.D. Pa. 1948). *See also Fischman* v. *Raytheon Mfg. Co.*, 9 F.R.D. 707, 710-711 (S.D.N.Y. 1949), *rev'd,* 188 F.2d 783 (2d Cir. 1951).

These early efforts to reconcile implied remedies with the express causes of action were soon overwhelmed by a snowballing trend following *Fischman* to create § 10(b) rights for virtually everything: not only did most lower courts abandon the restrictions found in the express rights, but they derived from § 10(b) "broad fiduciary duties," [15] and abandoned any notion of privity. *See Hooper* v. *Mountain*

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[15] *McClure* v. *Borne Chemical Co.*, 292 F.2d 824, 834 (3d Cir.), *cert. denied,* 368 U.S. 939 (1961).

States Securities Corp., 282 F.2d 195, 201 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961):

> Section 10(b) "greatly expands the protection frequently so hemmed in by the traditional concepts of common law misrepresentation and deceit, the requirement of privity, proof of specific damage, inadequacy of the right of recission or right to recover up to par value of stock of a much greater market value."

Those courts which even discussed the availability of a private action under § 10(b) seemed to think it was necessary because "defrauded sellers are given no civil remedy," a rationale that overlooks §§ 9 and 18 of the 1934 Act, *see Ellis* v. *Carter*, 291 F.2d 270, 273 (9th Cir. 1961), and consigns those sections to legal oblivion. The *Ellis* court at least acknowledged that the § 10(b) implied right "assumes that Congress in 1934 undid what it carefully did in 1933." *Id.* at 274.

The Court has in recent years acquiesced in the lower courts' implication of private remedies under § 10(b), *see, e.g., Blue Chip Stamps*, 421 U.S. at 736-38, while at the same time limiting the scope of such actions, *id.* at 755, and reserving the precise issue here presented: "whether an implied action under § 10(b) . . . will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act." *Id.* at 752 n.15; *see id.* at 736 n.8.

The Court recently interpreted the intent of Congress, at the time of passage of the 1974 Commodity Exchange Act, in light of a general acceptance by lower courts in 1974 of an implied action under a general antifraud provision. *See Merrill Lynch*, 102 S.Ct. at 1839-41. However, as the Court recognized in *Merrill Lynch* itself, *id.* at 1845 n.88, the judicial implication of § 10(b) remedies—whatever its bearing on interpretation of recent congressional enactments—has no bearing on the intent of Congress in 1933 and 1934, which is the only relevant inquiry. *Touche Ross*, 442 U.S. at 574-75 n.16.

C. The "Need" for Implied Actions on a Registration Statement

The court of appeals reasoned that an implied remedy was necessary because persons injured by a misleading prospectus but not entitled to sue under § 11—*i.e.*, persons who did not purchase any of the registered securities—might otherwise be left without a federal remedy. *See Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d at 787.[16]

As noted above, however, the argument of "need" has "little relevance," *Touche Ross*, 442 U.S. at 575-76; *see Aaron* v. *SEC*, 446 U.S. at 700 n.19, and proves too much. If Congress, in the comprehensive remedial scheme of § 11, chose not to grant some persons a federal remedy on a misleading prospectus, courts "are not authorized to ignore this legislative judgment." *Sea Clammers*, 453 U.S. at 18; *accord, Touche Ross* v. *Redington*, 442 U.S. at 578 (not for courts to "improve upon the statutory scheme that Congress enacted into law").

Further, the concern expressed below has a hollow sound since the plaintiffs here, unlike those in *Fischman*, are purchasers of registered securities. Whatever their reasons for delaying almost two years after bankruptcy to commence their action, the remedy expressly provided by Congress in § 11 was available to them had they sought it within the time Congress fixed.

In any event, on its own terms, the decision in *Fischman* and similar cases to provide a remedy for every complainant on a prospectus is mistaken. Absent common-law restraints or legislative restrictions, claims of injury due

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[16] The court below also relied on *Wachovia Bank & Trust Co.* v. *National Student Marketing Corp.*, 650 F.2d 342 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981), but this case does not involve the question in *Wachovia*—whether false statements in a private placement memorandum (*i.e.*, a prospectus for unregistered securities) give rise to a private right of action under § 10(b). *Wachovia's* rejection of the express remedy afforded by § 12(2) of the 1933 Act in favor of a judicially implied remedy under § 10(b), however, was based on the same erroneous notion that the courts are empowered to trade off elements of their own choosing for legislatively prescribed limitations.

to a misrepresentation can be asserted by a virtually limitless class. *See* W. PROSSER, LAW OF TORTS 702 (1964):

> "[T]he class of persons who may conceivably learn of a misstatement and be influenced by it is so enormous that an impossible burden, likely to be out of all proportion to the fault involved, might be cast upon anyone who makes a false assertion."

Society is hardly well-served by imposing "impossible burdens" on the conduct of commerce, a fact which led Chief Judge Cardozo to refuse to adopt a rule of decision that would give rise to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Ultramares* v. *Touche*, 255 N.Y. 170, 179-80, 174 N.E. 441, 444 (1931); *cf. Cannon* v. *University of Chicago*, 441 U.S. at 692 n.13.[17]

In *Blue Chip Stamps*, 421 U.S. at 736-49, the Court emphasized the necessity of restricting the scope of securities litigation, and held that courts should not expand the class of plaintiffs beyond the boundaries established by Congress. The Court stated, *id.* at 736 & n.8:

> "It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.[8]

> "[8] On these facts, . . . extension of a Rule 10b-5 cause of action, far from closing an unforeseen

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[17] It bears remembering that in 1933 and 1934 Cardozo was recognized as the leading commercial judge in the common-law world and *Ultramares* viewed as one of his landmark opinions. The teaching of that opinion, as clear and sensible now as then, formed part of the common frame of reference of those who served in Congress, and the care and precision with which they framed the civil liabilities provisions of the 1933 and 1934 Acts reflect their fidelity to its caution against the oppression of unlimited liability. To be sure, Congress enlarged upon the liabilities established at common law, but it did so only to the extent that in its considered judgment was appropriate, taking into account all aspects of the public interest.

> loophole, would extend a private right of action for misrepresentations in a 1933 Act prospectus to those whom Congress excluded from the express civil remedies provided in the 1933 Act to cover such a violation."

The basic premise of § 11 is that money obtained from investors through a false prospectus should be returned to them. Allowing recovery to persons who did not buy the registered securities but whose investment decisions are claimed to have been affected by false statements in the prospectus upsets this legislative scheme. Were such additional liabilities to be imposed on an issuer, its shareholders —parties innocent of wrongdoing—would have to bear damage awards unrelated to any benefit the issuer received. Congress saw no "need" to impose such burdens on the capital formation process, and it is not the province of the courts to do so.[18]

D. The "Additional Element of Fraud," and the Nullification of § 11

The court below also reasoned that its alternative remedy did not conflict with § 11's express remedies because the "additional element of fraud" is required in § 10(b) implied actions. *See Fischman* v. *Raytheon*, 188 F.2d at 786-87.[19] Congress, however, nowhere intimated that the

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[18] The notion advanced by the court below and other courts—that restriction of actions to the express liability provisions would " 'encourage corporate managers to include these misrepresentations in material filed with the SEC, for the sole purpose of insulating themselves from liability under § 10(b)' " (A10, quoting *Ross* v. *A.H. Robins Co.*, 607 F.2d 545, 556 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980))—seem implausible. Anyone perpetrating such carefully conceived and grandoise frauds would be subject to felony prosecution under § 24 of the 1933 Act or § 32 of the 1934 Act, 15 U.S.C. § 77x (1976) and § 78ff (1980 Supp.).

[19] This justification would be unavailable were private rights of action to be implied under § 17(a)(2) and (3) of the 1933 Act, unless the Court distinguished between the standard applicable for government injunctive relief and that for private damage actions. *See Aaron* v. *SEC*, 446 U.S. at 695-702.

balance it struck was subject to judicial readjustment, or that it enacted § 11 only as an alternative to whatever different remedies courts might choose to devise for misstatements in a prospectus.

The court of appeals' analysis further assumes that § 11 embodies a simple trade-off between eliminating the culpability required at common law and imposing other restrictions. But § 11 does much more than merely eliminate plaintiffs' burden on culpability. The statute imposes a new liability on underwriters, experts and individuals, created by § 11 and non-existent outside of § 11. Common law requirements of privity, causation and reliance are all abandoned, and replaced by statutory modifications. The damage provisions are wholly legislative, and specific. This comprehensive remedial scheme is the antithesis of anything resembling a simple trade-off based on dispensing with *scienter* alone.

The error perpetuated below has in fact led to a complete disruption of the legislative scheme, whereby § 11 has as a practical matter been rewritten in an unrecognizable form under the guise of § 10(b). By employing the concept of "aiding and abetting" and a diluted version of *scienter*—here the giving of "substantial assistance, support or encouragement . . . 'recklessly' " (150a)—the "additional element of fraud" is replaced by something less. Then plaintiffs are allowed to prove this something less by reference, as here, to the special "duty of due diligence" claimed to be owed by defendants. *See* pages 3-4, notes 2 and 3, *supra; Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 369-73 (2d Cir. 1973), *rev'd on other grounds*, 430 U.S. 1 (1977) (*scienter* proven by breach of "duty of due diligence").[20]

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[20] Additional examples of lack of "due diligence" as a basis for § 10(b) liability include *Shores* v. *M.E. Ratliff Investment Co.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 98,425, at 92,542 (N.D. Ala. 1982)

(footnote continued on following page)

Upon so establishing "fraud", plaintiffs are freed from the offsetting limitations of § 11. The action on a prospectus is brought, as here, after the 1933 Act limitations period has expired. Plaintiffs are never required to post a bond for costs, *see Ernst & Ernst*, 425 U.S. at 210-11 n.30, and extensive discovery usually precedes trial if it does not induce defendants to settle even spurious claims. *See Blue Chip Stamps*, 421 U.S. at 741.

No legislative warrant exists for the courts to allow recovery based on the special duties and expanded class of defendants legislated by Congress only for a § 11 claim, and then to expand the class of plaintiffs beyond § 11's bounds and shed as well the most significant of § 11's restrictions—the short statute of limitations and the restriction on damages. Implied actions under § 10(b) for a misleading prospectus are improper under established canons of statutory construction; as importantly, to countenance such actions would actually nullify the careful balance expressly mandated by Congress in § 11.

III.

If Any Implied Remedy Is Allowed, It Must Be Subject to Restrictions Expressly Imposed by Congress.

Each of Congress's enactments in the securities field that provides actions for personal recovery of damages is subject to a one-year/three-year statute of limitations. *See* § 13 of the 1933 Act (for §§ 11 and 12); §§ 9 and 18 of the 1934 Act (*cf.* § 29(b)); § 16(a) of the Public Utility Holding Company Act, 15 U.S.C. § 79p; § 323(a)

(footnote continued from preceding page)

(in Rule 10b-5 implied action, bank held liable as an "underwriter" for "failure to investigate" and because it "should have known that buyers were in danger of being mislead"); *Blakely* v. *Lisac*, 357 F. Supp. 255, 263-64, 266-67 (D. Ore. 1972) (in Rule 10b-5 action for fraudulent prospectus, financial advisor "did nothing which approached due diligence" and, with respect to the attorney, "[t]he sole issue here is whether Gygi sustained his due diligence defense").

of the Trust Indenture Act, 15 U.S.C. 17www. In each instance, Congress also provided for a bond for costs and attorneys' fees "to discourage blackmail suits." *See* H.R. CONF. REP. No. 1838, 73d Cong., 2d Sess. 42 (1934).

Courts have refused, however, to apply Congress's judgment on the limitations period in implied remedies, citing the general proposition stated in *Holmberg* v. *Armbrecht*, 327 U.S. 392, 395 (1946), that the "silence of Congress has been interpreted to mean that it is federal policy to adopt the local law of limitation." Courts have taken a similar position with respect to the bond for costs and attorneys' fees. *See generally Ernst & Ernst*, 425 U.S. at 210-11 nn. 29, 30.

Congress, however, has not been "silent" on either of these questions; it could not have spoken louder as to the "federal policy" for procedures that govern private remedies under the securities laws. Every private damages remedy it created—no matter what its elements—incorporates the short statute of limitations and the protection against blackmail suits. See the Appendix hereto.

Likewise, in creating liability for an underwriter for the benefit of a class broader than the purchasers from that underwriter, Congress expressly prescribed in § 11(e) that the liability of a 1933 Act underwriter be limited to the "total price at which the securities underwritten by him and distributed to the public were offered to the public." The particular amendment containing this limitation was termed "the most important of all" the amendments to the 1933 Act adopted as part of the 1934 Act. See pages 14-15, *supra*.

The Court has recognized that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. It was because of similar considerations that Congress carefully delimited the remedial provisions of the 1933 and 1934 Acts (pages 11-17, above). While the Court must itself

"judicially delimit" the § 10(b) implied remedy, if any, *id.* at 749, Congress's uniform specification of a limitations period and a bond would appear to compel their application in any implied remedies. *See* Williams, *The Effect of Penal Legislation in the Law of Tort*, 23 MOD. L. REV. 233, 244 (1960) ("where a statute gives a civil remedy which is hedged about by restrictions, it would not be permissible to ignore the restrictions by implying an unrestricted right of action in tort"). The same conclusion applies to the limitation of an underwriter's liability specified in § 11(e), as amended by the 1934 Act itself.

IV.

"Scienter" Must Be Proven by Clear and Convincing Evidence.

This Court held in *Ernst & Ernst* v. *Hochfelder* that *scienter*—"a mental state embracing intent to deceive, manipulate, or defraud"—was a necessary element of any implied private action under § 10(b). 425 U.S. 185, 193 n.12. The court below correctly followed the common law and the majority of federal courts in holding that a plaintiff must prove *scienter* by "clear and convincing evidence" rather than, as in ordinary civil actions, by a preponderance of the evidence.

As the Court stated in *Chiarella* v. *United States*, 445 U.S. 222, 234-35 (1980), "Section 10(b) is aptly described as a catch-all provision, but what it catches must be fraud." *Accord, Blue Chip Stamps*, 421 U.S. at 731. The legislative history clearly supports this conclusion. *See Ernst & Ernst*, 425 U.S. at 201-14. Rule 10b-5 itself was promulgated to "close a loophole in the protections against fraud" and prohibited persons from purchasing securities "if they engaged in fraud in their purchase." SEC Release No. 3230 (May 21, 1942).

At common law, claims of fraud require proof by "clear and convincing evidence." 9 WIGMORE ON EVIDENCE

§ 2498, at 424 (Chadbourne rev. ed. 1981). This standard was well established at the time of enactment of the 1933 and 1934 Acts,[21] and "[w]e cannot assume that Congress, in enacting legislation to prevent fraudulent practices . . ., was unaware of . . . the common law of fraud." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *accord, Aaron* v. *SEC*, 446 U.S. at 693. Because this is the standard "typical[ly] use[d] . . . in civil cases involving allegations of fraud," *Addington* v. *Texas*, 441 U.S. 418, 424 (1979), it has been adopted under other federal statutes. *E.g., Pereira* v. *United States*, 347 U.S. 1, 10 (1954) (mail fraud); *Foster* v. *Commissioner*, 487 F.2d 902, 903 (6th Cir. 1973) (tax fraud).

The origin of the higher standard of proof for claims of fraud lies in the heinous nature of the allegation, and in the problematic nature of the proof. Unlike other intentional torts, claims of fraudulent misrepresentation hinge not merely on proof that an objective act was intended (as, for example, in the tort of battery), but rather on proof regarding the defendant's state of mind. *See Blue Chip Stamps*, 421 U.S. at 743-45. Proof of fraudulent intent is often circumstantial, a problem exacerbated in securities cases by the need to draw inferences from complicated and equivocal facts.[22]

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[21] *E.g., Oriel* v. *Russell*, 278 U.S. 358, 364 (1929); *Barbano* v. *Central-Hudson Steamboat Co.*, 47 F.2d 160, 163 (2d Cir. 1931); *Bowe* v. *Gage*, 127 Wis. 245, 251, 106 N.W. 1074, 1076 (1906).

[22] *See generally* W. PROSSER, LAW OF TORTS 700-02 (1964). Reckless behavior, *properly defined*, theoretically may be a form of intentional misconduct and provide a basis for liability for fraud under common law. But such recklessness requires actual intent—not necessarily to achieve the specific result, but *deliberately* to disregard an obvious risk of substantial harm. L. Green, *Deceit*, 16 VA. L. REV. 749, 752-53 (1930). Many courts, however, appear to equate recklessness with a standard that can perhaps best be described as "really negligent." *See* pages 3-4, note 3, *supra; see also Seiffer* v. *Topsy's International, Inc.*, 487 F. Supp. 653, 664 (D. Kan. 1980) ("Reckless conduct . . . includes what is sometimes referred to as 'gross negligence.' "); *Stern* v. *American Bankshares Corp.*, 429

(footnote continued on following page)

In *Steadman* v. *SEC*, 450 U.S. 91 (1981), the Court held that administrative proceedings under § 10(b) were governed by a lesser standard, but only because of an express mandate to this effect by Congress in the Administrative Procedure Act: "Where Congress has spoken, we have deferred . . . ." 450 U.S. at 95.[23] Congress, of course, did not propound a novel standard of proof to apply to implied private actions under § 10(b), and in the absence of "explicit evidence of congressional intent" to depart from "established doctrine," *see Chiarella* v. *United States*, 445 U.S. at 223, the clear and convincing standard must be retained.

Application of the higher standard may have little effect, however, unless courts use it to find genuine intent. The distinction between negligence and intentional deceit is sharp in concept, but may be difficult for a finder of fact to appreciate when confronted by extensive circumstantial evidence. It is thus important both that clear and convincing evidence be required and that *scienter* be plainly defined as actual subjective intent to deceive, manipulate or defraud, and nothing less. Even a phrase such as "conduct the equivalent of intentional conduct" is unclear as a definition of *scienter* and serves only to create confusion.

(footnote continued from preceding page)

F. Supp. 817, 827 (E.D. Wis. 1977) (liability accrues under § 10(b) when "the defendants knew or should have known of the facts and circumstances concerning the fraud"). Experience shows that acceptance of recklessness as a standard of liability under § 10(b) "would effectively mean liability for negligence," which "would contravene the rule of *Ernst & Ernst.*" *Spelman* v. *F&M Bank & Trust Co.*, No. 80-C-106-BT (N.D. Oklahoma July 6, 1981).

[23] The Court in *Steadman* consequently did not utilize the common law rule, or the balancing test which was adopted by *Addington*, 441 U.S. at 423-25, for situations where there was no well-established standard of proof. Application of the *Addington* test here would require the higher standard. In a private action, only the monetary interests of the individual plaintiffs are weighed against the defendants' interests, which, in the case of fraud allegations, are "more substantial than mere loss of money." *Addington*, 441 U.S. at 424. In the case of accountants or underwriters, a finding of fraudulent deceit could materially impair their professional reputation, or worse

Conclusion

For the reasons stated, the express remedies provided by Congress for a misleading prospectus preclude implication of remedies for the same conduct under § 10(b) of the 1934 Act or § 17(a) of the 1933 Act. In any implied actions that may be allowed under those provisions, basic procedural rules and limitation of liability established by Congress for express actions should be observed, and plaintiffs should be required to meet their burden of proving actual deceit by clear and convincing evidence.

Respectfully submitted,

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June 19, 1982

APPENDIX

Analysis of Private Damages Provisions of the Securities Laws

	Burden of Proof and Culpability Standards	*Statute of Limitations*	*Protection from Blackmail Suits*
Securities Act of 1933			
§ 11	Defendants (other than issuer) have reasonable belief/reasonable investigation defense. (15 U.S.C. § 77k(b))	One year/ three years (15 U.S.C. § 77m)	Bond for Costs and Attorneys' Fees (15 U.S.C. § 77k(e))
§ 12(1)	Absolute liability. (15 U.S.C. § 77*l*(1))	One year/ three years (15 U.S.C. § 77m)	Bond for Costs and Attorneys' Fees (15 U.S.C. § 77k(e))
§ 12(2)	Defendant has ignorance/reasonable inquiry defense. (15 U.S.C. § 77*l*(2))	One year/ three years (15 U.S.C. § 77m)	Bond for Costs and Attorneys' Fees (15 U.S.C. § 77k(e))
Securities Exchange Act of 1934			
§ 9	Plaintiff must prove "willful" misconduct. (15 U.S.C. § 78i(e))	One year/ three years (15 U.S.C. § 78i(e))	Bond for Costs and Attorneys' Fees (15 U.S.C. § 78i(e))
§ 18	Defendant has good faith/ignorance defense. (15 U.S.C. § 78r(a))	One year/ three years (15 U.S.C. § 78r(c))	Bond for Costs and Attorneys' Fees (15 U.S.C. § 78r(a))
Public Utility Holding Company Act			
§ 16a	Defendant has good faith/ignorance defense. (15 U.S.C. § 79p(a))	One year/ three years (15 U.S.C. § 79p(a))	Bond for Costs and Attorneys' Fees (15 U.S.C. § 79p(a))
Trust Indenture Act			
§ 323	Defendant has good faith/ignorance defense. (15 U.S.C. § 77www)	One year/ three years (15 U.S.C. § 77www)	Bond for Costs and Attorneys' Fees (15 U.S.C. § 77www)

Amicus Brief

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Nos. 81-680, 81-1076

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

HERMAN & MACLEAN,

Petitioner-Cross-Respondent,

v.

RALPH E. HUDDLESTON, *et al.*,

Respondents-Cross-Petitioners.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF PEAT, MARWICK, MITCHELL & CO. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER HERMAN & MACLEAN

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Question Presented

Peat, Marwick, Mitchell & Co. confines its participation as *amicus curiae* to the question presented in No. 81-680 by petitioner Herman & MacLean:

> "Does an implied remedy exist under either § 10(b) of the Securities Exchange Act of 1934 or § 17(a) of the Securities Act of 1933 for purchasers of securities who have an express remedy under § 11 of the Securities Act of 1933 by virtue of the fact that the securities purchased were issued pursuant to a registration statement filed as required by § 5 of the Securities Act of 1933?"

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Nos. 81-680, 81-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

HERMAN & MACLEAN,

Petitioner-Cross-Respondent,

v.

RALPH E. HUDDLESTON, *et al.*,

Respondents-Cross-Petitioners.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF PEAT, MARWICK, MITCHELL & CO. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER HERMAN & MACLEAN

Peat, Marwick, Mitchell & Co. ("PMM"), by consent of the parties, submits this brief as *amicus curiae* pursuant to Rule 36 of the Rules of the Court in support of the petitioner Herman & MacLean and urges the Court to reverse the decision of the court of appeals for the Fifth Circuit entered on March 9, 1981.

PMM confines its participation as *amicus curiae* to the question presented in No. 81-680 by petitioner Herman & MacLean:

> "Does an implied remedy exist under either § 10(b) of the Securities Exchange Act of 1934 or § 17(a) of the Securities Act of 1933 for purchasers of securities who have an express remedy under § 11 of the Securi-

ties Act of 1933 by virtue of the fact that the securities purchased were issued pursuant to a registration statement filed as required by § 5 of the Securities Act of 1933†"

Interest of PMM as *Amicus Curiae*

PMM like Herman & MacLean is a firm of certified public accountants. PMM in the United States is the largest accounting firm, with some 1260 partners and principals and some 8000 members of its professional staff in offices in 44 states.

A substantial percentage of PMM's United States clients are public companies. The financial statements of such companies audited by PMM as independent certified public accountants are required to be included in registration statements and other reports which the companies file with the Securities and Exchange Commission (the "SEC") and disseminate to investors pursuant to the regulatory scheme enacted through the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"). On behalf of its professional members and employees PMM has a most direct, immediate and real interest in the resolution of the instant question concerning the scope and bases of civil liability under the federal securities laws.

Congress did not contemplate private damage suits under § 10(b) of the 1934 Act and did not define the elements of the cause of action which has been judicially "implied." Litigation under § 10(b) has evolved into disputes over what are the elements of the cause of action. Answers are provided only sporadically and different courts have differently defined the elements of the "implied" cause of action in analogous cases.

PMM is concerned over the lack of guidance provided in litigation under § 10(b) because like other accounting firms it is a target for class actions brought under that provision involving large sums of money. Such litigation is largely a game of chance; the question whether to settle or litigate cannot be intelligently resolved.

PMM submits that the ambiguities and uncertainties are unnecessary and may be largely eliminated by adherence to the standards for civil liability enacted by Congress in the express remedy provisions of the 1933 Act and the 1934 Act.

No Legitimate Purpose Is Served by Judicial "Implication" of a Private Cause of Action Differing From the Express Causes of Action Enacted by Congress.

The absence of recognized criteria and content for the "implied" § 10(b) cause of action is strikingly evidenced by the court's statements in *Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). The court said that if discovery concerning causation issues became "time-consuming" a district court might resort to "extensive powers to expedite the suit with procedural innovations" or "reconsider" whether there should be any causation element (524 F.2d at 907 n.22). Most particularly, the court said:

> "Indeed, we could, in the exercise of our Article III jurisdiction, transform the 10b-5 suit from its present private compensatory mold by predicating liability to purchasers solely on the materiality of a misrepresentation (*i.e.*, economic damage) regardless of transactional causation. . . ." (524 F.2d at 908 n.24)

The decision in *Blackie* was cited with approval in *Ross* v. *A.H. Robins Co.*, 607 F.2d 545, 553 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980), and *Wachovia Bank and Trust Co.* v. *National Student Marketing Corp.*, 650 F.2d 342, 358 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981), which in turn were followed by the court below (640 F.2d at 542).

The Court has held that the role of the judiciary is "limited solely to determining whether Congress intended to create the private right of action asserted," *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979). It has emphasized that " 'where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it,' " *Kissinger* v. *Reporters Committee for Freedom of the Press*, 445 U.S. 136, 148-49 (1980), and that the *expressio unius* rule of construction may yield only "to persuasive evidence of a contrary legislative intent," *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, [illegible] (1979).

The Court also has held that a private damage action "was not within the contemplation of the Congress that enacted § 10(b)" of the 1934 Act, *Aaron* v. *SEC*, 446 U.S. 680, 691 (1980). It should follow that there is no private cause of action under § 10(b) when the actions alleged are the subject of one of the express remedies enacted by Congress.*

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* PMM will focus on § 10(b) of the 1934 Act, 15 U.S.C. § 78j (b) (1976), because it is the more oft-abused, but the result in respect of § 17 of the 1933 Act, 15 U.S.C. § 77q (1976), should be equally clear in view of the explicit intention of Congress that §§ 11 and 12 of the 1933 Act, 15 U.S.C. §§ 77k and 77l (1976), would "create and define the civil liabilities imposed by the act," H.R. Rep. No. 85, 73d Cong., 1st Sess. 9 (1933), that § 17 would empower the Government to seek injunctive relief or "prosecute criminally" those "guilty of fraud," S. Rep. No. 47, 73d Cong., 1st

The court of appeals did not refer to Congressional intent. It said it was " 'not being asked to create a new judicial remedy' " and " '[i]t is well established that a private remedy exists' under Section 10(b)" (640 F.2d at 542).

There is no history, however, of post-enactment "legislative approval or acquiescence . . . for the Rule 10b-5 remedy," *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 50 U.S.L.W. 4457, 4467 n.88 (U.S. May 3, 1982). To the contrary, shortly after Congress amended the 1934 Act in 1975* the Court recognized and expressly left open the instant question "whether an implied action under § 10(b) of the 1934 Act . . . lie[s] for actions [which are] the subject of express civil remedies under the 1933 Act," *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 752 n.15 (1975). The Court said in *Blue Chip Stamps:*

> "We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the question." (421 U.S. at 749)

This is not a case such as *Curran* where "the legislative history of the statute persuasively indicates" that "Con-

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Sess. 6 (1933), and that "No civil liability attaches for any violation thereof," 78 Cong. Rec. 8712 (1934) (explanatory memorandum of Sen. Fletcher). There has been disagreement among the lower courts concerning whether a private cause of action ever may be "implied" under § 17 and the Court has three times expressly left open the question whether there is such an "implied" cause of action, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 734 n.6 (1975); *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 557 n.9 (1979); *Aaron* v. *SEC*, 446 U.S. at 689.

* Pub. L. No. 94-29, 89 Stat. 97 (June 4, 1975). The legislative history of the 1975 amendments reveals that Congress did not consider the question of private causes of action.

gress intended to preserve the preexisting remedy" (50 U.S.L.W. at 4464-65).*

The Court, moreover, has only "assumed" the existence of an "implied" § 10(b) cause of action, *Curran*, 50 U.S.L.W. at 4464; *Aaron* v. *SEC*, 446 U.S. at 689, and "whether a cause of action exists" is a question the answer to which "may be assumed without being decided," *Burks* v. *Lasker*, 441 U.S. 471, 476 n.5 (1979); *Maine* v. *Thiboutot*, 448 U.S. 1, 29-32 (1980) (Powell, J., dissenting). The Court has only assumed the existence of a private cause of action under § 10(b) "in some circumstances," *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977), and it has expressly left open the question presented.

The instant question has not been "squarely" decided and, accordingly, is an "open one calling for a canvas of the relevant considerations," *Hagans* v. *Lavine*, 415 U.S. 528, 535 n.5 (1974). *See also Monell* v. *Department of Social Services*, 436 U.S. 658, 695, 700 (1978).**

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* The court of appeals also held that invocation of the "established" § 10(b) remedy does not "impermissibly nullify" limitations imposed by Congress on liability under the express remedy provisions because "[t]o prevail under Section 10(b) a plaintiff must prove facts not necessary to recover under the [express remedy] provisions [, *viz.*,] deceit committed with scienter" (640 F.2d at 542) (footnotes omitted). The scienter requirement, however, was judicially imposed by the Court's 1976 decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), after the Court posed and left open the instant question in *Blue Chip Stamps*. The Court observed in *Hochfelder* that "[c]ourts and commentators long have differed with regard to whether scienter is a necessary element of such a cause of action" (425 U.S. at 197); the Court did not indicate that by imposing a scienter requirement it intended to foreclose the question it left open in *Blue Chip Stamps*. Indeed, in *Hochfelder* the Court recognized and expressly left open the question whether "a cause of action may be maintained under § 10(b) on the basis of actions that would constitute a violation of § 18 [of the 1934 Act]" (425 U.S. at 211 n.31).

** Since the question was posed by the Court a number of district courts have held in actions under the federal securities laws that

PMM agrees with Herman & MacLean that Congressional intent should be the sole consideration in resolving the question presented and that the question presented must be answered in the negative if that standard is applied. This brief is submitted to address the different consideration upon which the court of appeals focused.

The history of the judicially "implied" § 10(b) cause of action to which the court of appeals referred does not support the invocation of the remedy where the conduct alleged is the subject of an express remedy provision. History has shown, PMM submits, that an "implied" § 10(b) cause of action is an inefficient substitute for the express causes of action. To the extent history is relevant it provides substantial cause for adhering to Congressional intent in resolving the question presented.

The rationale for the first "implication" of a private cause of action under § 10(b), *Kardon* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946), was the common law concept of statutory tort. While Judge Kirkpatrick who decided *Kardon* declined to apply that doctrine to the case where the conduct alleged is the subject of one of the ex-

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the express remedy provisions provide the exclusive remedies. *See McKee* v. *Federal's Inc.*, [1979] CCH Fed.Sec.L.Rep. ¶ 96,958 at 96,023 (E.D.Mich. 1979); *Pearlstein* v. *Justice Mortgage Investors*, [1979] CCH Fed.Sec.L.Rep. ¶ 96,760 at 94,974-75 (N.D. Tex. 1978); *Kulchok* v. *Government Employees Ins. Co.*, [1977-1978] CCH Fed.Sec.L.Rep. ¶ 96,002 at 91,512 (D.D.C. 1977). *See also McFarland* v. *Memorex Corp.*, 493 F.Supp. 631 (N.D. Cal. 1980); *Nemo* v. *Allen*, 466 F.Supp. 192, 196 (S.D.N.Y. 1979); *Clayton* v. *Skelly Oil Co.*, [1977-1978] CCH Fed.Sec.L.Rep. ¶ 96,269 at 92,746 n.1 (S.D.N.Y. 1977); *Poller* v. *First Virginia Mortgage and Real Estate Investment Trust*, [1978] CCH Fed. Sec.L.Rep. ¶ 96,564 at 94,352 (E.D. Va. 1978). For earlier decisions to the same effect, *see Montague* v. *Electronic Corp. of America*, 76 F.Supp. 933, 935 (S.D.N.Y. 1948); *Rozenberg* v. *Globe Aircraft Corp.*, 80 F.Supp. 123, 125 (E.D. Pa. 1948); *Drake* v. *Thor Power Tool Co.*, 282 F.Supp. 94 (N.D. Ill. 1967); *Gilbert* v. *Nixon*, 429 F.2d 348, 355 (10th Cir. 1970).

press remedy provisions, *Rosenberg* v. *Globe Aircraft Corp.*, 80 F.Supp. 123, 124-25 (E.D. Pa. 1948), some courts have, *e.g.*, *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951) (relied upon by the court of appeals, 640 F.2d at 541). Indeed, the reason for recognizing an "implied" cause of action under § 10(b) where the conduct alleged is the subject of an express remedy provision could only be to foster some judicially conceived remedial goal—the belief that investors who have permitted the express remedy to lapse or are unable to establish one or more of the elements of the cause of action enacted by Congress should not be deprived of the opportunity to seek relief in federal court.

PMM submits, quite aside from whether the means employed are Constitutionally permissible, that due to the nature of the statute and the inability or unwillingness of the courts to develop any consensus concerning its application no legitimate remedial purpose has been furthered by judicial "implication" of a private cause of action under § 10(b).

Section 10(b) of the 1934 Act is a broad "catchall" provision according authority to the SEC to regulate the securities markets, *Hochfelder*, 425 U.S. at 203-04. Unlike the express remedy provisions, § 10(b) is not addressed to particular devices or participants in the securities markets and, since Congress did not contemplate a private remedy, it does not purport to set forth the elements of any cause of action.

> "[W]e are not dealing here with any private right created by the express language of § 10(b) or of Rule 10b-5. No language in either of those provisions speaks at all to the contours of a private cause of action . . ." (*Blue Chip Stamps*, 421 U.S. at 748-49)

Section 10(b) provides, accordingly, an expansive and fairly clean slate for purposes of constructing a remedy to those who would choose to recognize it as a vehicle for doing so.

For that reason among others the process of defining the contours of the remedy has been painfully slow. Courts proceed sporadically and provide answers only to questions presented in the peculiar contexts of the cases before them. Courts have demonstrated, moreover, a penchant for defining the "implied" cause of action differently even in analogous cases.

The process has been slowed even further because § 10(b) claims have been found to be particularly suited to class action treatment. The stakes are thus made very high. The absence of established limitations on liability and the potential scope of alleged liability to a class create immense settlement pressure even when a complaint "by objective standards may have very little chance of success," *Blue Chip Stamps*, 421 U.S. at 740. Settlement forestalls greater definition of the elements of the cause of action.*

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* Courts and commentators have expressed concern over the potentially "ruinous" dimensions of § 10(b) class action damage claims. Mullaney, *Theories of Measuring Damages in Security Cases and the Effects of Damages on Liability*, 46 Fordham L. Rev. 277 (1977). *See Fridrich* v. *Bradford*, 542 F.2d 307, 321-22 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977); *Elkind* v. *Liggett & Myers, Inc.*, 635 F.2d 156, 170 (2d Cir. 1980). As also has been observed, "the innocent stockholder [at the time of a judgment] would be ultimately the source of recovery," Note, *The Role of Scienter and the Need to Limit Damages in Rule 10b-5 Actions*, 59 Ky. L.J. 891 (1971), or, in some cases, "the customers," Note, *Rule 10b-5: The Rejection of the Birnbaum Doctrine by Eason* v. *General Motors Acceptance Corp. and the Need for a New Limitation on Damages*, 1974 Duke L.J. 610, 629 n.90. *See also* Judge Friendly's comment in the concurring opinion in *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), that "large judgments [are] payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers. . . ."

The Court observed in *Blue Chip Stamps* that settlement value exists "so long as [a plaintiff] may prevent the suit from being resolved against him by dismissal or summary judgment" (421 U.S. at 740) and, indeed, the pleadings are the field upon which the battle to obtain some direction has been fought. Resources are directed to Fed.R. Civ.P. 12(b)(6) and 56 motion practice as is apparent from even a cursory review of mushrooming reporters and services addressed to litigation under the federal securities laws. Liberal pleading rules, however, and the absence of clear statutory standards against which to measure a complaint do not encourage early judicial resolution.

Ultimate issues of injury and fault are seldom resolved. Actions under § 10(b) so rarely reach trial that, as the court of appeals accurately observed (640 F.2d at 554), "[t]he proper measure of the actual damages recoverable by the Rule 10b-5 plaintiff is 'the least formulated and the least reported upon' of all issues raised by a Rule 10b-5 claim." Such actions are most often settled. Whether members of the investor class are entitled to recover all or none of the damages alleged, they typically will recover a small fraction of that amount from the sport that ensues when the price of some stock declines.*

Settlement, of course, is not an evil per se. To the contrary, where two parties can resolve a dispute without judicial intervention based on an understanding of the

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* *See* Frankel, *Implied Rights Of Action*, 67 Va. L. Rev. 553, 574-75 (1981). *See also* Mullaney, *supra*, 46 Fordham L. Rev. at 277 ("The specter of ruinous damages if cases are tried to completion has often resulted in settlement . . . after the court's decision on the defendant's motion to dismiss the complaint, or on the plaintiff's motion to certify the case as a class action."); Reder, *Measuring Buyers' Damages in 10b-5 Cases*, 31 Bus. Law. 839 (1976) ("Rule 10b-5 under the [1934 Act] has spawned many plaintiffs but few judgment creditors.").

strengths and weaknesses of their respective positions each benefits. Where the difficulties of making such an assessment are a factor, however, the settlement has not served a legitimate purpose.

The latter condition prevails in litigation under § 10(b). Although an "implied" cause of action has been recognized by the federal courts for more than thirty years, questions remain concerning, *inter alia*, who has standing to assert such a claim, the degree of culpability required to warrant liability, when causation is an element of the claim and what statute of limitations should apply.

Standing and Scienter—In *Blue Chip Stamps* and in *Hochfelder* the Court in address to the adequacy of § 10(b) complaints formulated what appeared to be plain rules in respect of two elements of the "implied" cause of action. The Court held that a plaintiff must "purchase or sell" a security in connection with alleged misconduct (421 U.S. at 731) and plead and prove that a defendant acted with " 'scienter'—intent to deceive, manipulate, or defraud" (425 U.S. at 193). It might have been thought that those rulings would provide some certainty. Even in those areas, however, the lower courts have carved out factual distinctions and conflicting rules of pleading and evidence.

The "deferred" and "forced" seller "exceptions", for example, have developed under *Blue Chip Stamps*.* And lower courts have held that allegations amounting to "recklessness" will satisfy the scienter requirement in most circumstances.** "Recklessness" in contrast to "intent to de-

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* *Alley* v. *Miramon*, 614 F.2d 1372, 1384-87 (5th Cir. 1980), and the authorities cited therein. *See also Engl* v. *Berg*, 511 F. Supp. 1146, 1152 (E.D. Pa. 1981).

** *See, e.g., Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1023-24 (6th Cir. 1979); *Nelson* v. *Serwold*, 576 F.2d 1332, 1337 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978); *Rolf* v. *Blyth, East-*

ceive" is a pliable measure and efforts to define it have resulted in varying formulations.*

The lower courts also have devised private remedies under § 10(b) for "secondary" liability which further modify the scienter standard. Some lower courts have recognized, although others have declined to recognize, an "implied" § 10(b) cause of action for vicarious liability under the common law absolute liability standard of *respondeat superior*.** Most lower courts have recognized although constructed differently an "implied" cause of action for "aiding and abetting" a violation of § 10(b)

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man Dillon & Co., 570 F.2d 38, 44 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *Coleco Industries, Inc.* v. *Berman*, 567 F.2d 569, 574 (3d Cir. 1977), *cert. denied*, 439 U.S. 830 (1978); *First Virginia Bankshares* v. *Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied*, 435 U.S. 952 (1978); *Sundstrand Corp* v. *Sun Chemical Corp.*, 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

* *See, e.g., Mansbach* v. *Prescott, Ball & Turben, supra*, 598 F.2d at 1025 and n.36: "Requiring a plaintiff to show that the defendant acted with actual subjective intent to defraud could impose a great burden upon recovery. . . . We believe that *Hochfelder* should be read to go no further than its specific holding that mere negligence is not enough. . . . It is not necessary for us to precisely define what constitutes reckless behavior since it is ultimately a factual determination which will necessarily vary from case to case. . . . In *Sanders, supra*, 554 F.2d at 793, the seventh circuit noted that this standard is closer to a lesser form of intent than a greater form of negligence. We think it suffices to say that the standard falls somewhere between intent and negligence. There is little analytical value in deciding precisely where along this spectrum recklessness falls."

** Some lower courts have refused to recognize an "implied" cause of action under § 10(b) for vicarious liability. *Compare Kamen & Co.* v. *Paul H. Aschkar & Co.*, 382 F.2d 689, 697 (9th Cir. 1967), *cert. granted*, 390 U.S. 942, *cert. dismissed*, 393 U.S. 801 (1968), and *Haynes* v. *Anderson & Strudwick, Inc.*, 508 F. Supp. 1303, 1312 (E.D. Va. 1981), *with Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705, 710-16 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980), and *Sharp* v. *Coopers & Lybrand*, 649 F.2d 175, 180-84 (3d Cir. 1981), *cert. denied*, 102 S.Ct. 1427 (1982).

against persons who in one form or another may have assisted in the securities transaction.*

The contradictions and ambiguities do not arise under the express remedy provisions. As the Court said in *Blue Chip Stamps*, 421 U.S. at 728, 736-37, and in *Hochfelder*, 425 U.S. at 207-210, Congress "clearly specified" which persons are entitled to relief and the "state of mind" of the defendant necessary to support a judgment, *id.* at 207, 209 n.28, in §§ 11 and 12 of the 1933 Act, 15 U.S.C. §§ 77k and 771 (1976), and §§ 9 and 18 of the 1934 Act, 15 U.S.C. §§ 78i and 78r (1976). There is no express private cause of action under the 1933 Act or the 1934 Act for vicarious liability or "aiding and abetting" a violation of those statutes. "Secondary" liability is imposed under § 15 of the 1933 Act, 15 U.S.C. § 77o (1976), and § 20(a) of the 1934 Act, 15 U.S.C. § 78t(a) (1976), only against those who "control" persons who violate the Acts where the "controlling person" had "knowledge" of the violation (§ 15) or did not act in "good faith" (§ 20(a)).

Reliance—Considerable but needless uncertainty also arises in litigation under § 10(b) in connection with the causation element. While the element of causation in fact, or reliance, should provide an objective standard against which the adequacy of pleadings and the scope of alleged liability could be realistically assessed, *see Hochfelder*, 425 U.S. at 215-16 n.33, it has given rise only to more variations.

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* *See, e.g., IIT* v. *Cornfeld*, 619 F.2d 909, 922-27 (2d Cir. 1980), and the authorities cited therein. As Judge Friendly stated in *Cornfeld*, "the exact content of the rather vague phrases [used by the courts in defining elements of an "implied" cause of action for "aiding and abetting"] is still being delineated by the courts." (619 F.2d at 922)

The Court has left open the question whether any private cause of action is "implied" under § 10(b) against alleged "aiders and abettors," *Hochfelder*, 425 U.S. at 192 n.7.

In *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-54 (1972), the Court held that affirmative proof of reliance was not required where a bank and its employees purchased stock from unsophisticated members of the Ute tribe in a face-to-face transaction without disclosing that the stock was being traded in a secondary market at a higher price. The lower courts have taken *Affiliated Ute* to mean that reliance may be "presumed" in any action under § 10(b) where a complaint concerns alleged omission of fact, rather than affirmative misrepresentation of fact, and have differed in their decisions concerning what constitutes an "omission" case as opposed to a "misrepresentation" case.

Some courts have held that any complaint relating to a written report constitutes a "misrepresentation" case, even if the claim is that the document "omitted" information, since it is not difficult to prove reliance on a document as opposed to a person who "stand[s] mute" (406 U.S. at 153).* Other courts have held that any allegation of an omission, whatever the context, gives rise to a "presumption" of reliance.** Other courts recently have constructed

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* *E.g.*, *Vervaecke* v. *Chiles, Heider & Co.*, 578 F.2d 713, 718-19 (8th Cir. 1978); *Beissinger* v. *Rockwood Computer Corp.*, 529 F.Supp. 770, 784-85 (E.D. Pa. 1981). *See also Fridrich* v. *Bradford, supra*, 542 F.2d at 320.

** *See, e.g.*, *Rifkin* v. *Crow*, 574 F.2d 256, 263 (5th Cir. 1978); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1344 (E.D. Pa. 1972), *aff'd*, 494 F.2d 528 (3d Cir. 1974). *See also Sharp* v. *Coopers & Lybrand, supra*, where the court held that there should not be a "distinction between the treatment of misrepresentations and omissions" and adopted a third approach that presumes reliance " 'where it is logical' to do so" (649 F.2d at 188). The court expressly rejected any " 'attempt to inject more certainty into the allocation of the burden of reliance' " (*id.* at 189 n.19) and held that proper allocation of the burden of proof is an issue of fact to be resolved on a case-by-case basis in view of the "likelihood that investors would rely" (*id.* at 189).

a new "presumption," whereby reliance is "presumed" whether the complaint concerns a written report or face-to-face negotiations and whether it alleges misrepresentation or omission, if there is an allegation that the market price of a stock was affected by an alleged misstatement—the "presumption" is that the investor relied upon the "integrity of the market" and the rule seems to be that such "presumed" reliance constitutes an adequate link between a misleading statement or report and injury to an investor.*

Most courts have held, moreover, that the requirement of pleading and proving reliance, if it applies, should not be permitted to interfere with the class action process, and that resolution of causation issues (which define the potential scope of liability, if any) should be deferred until other issues such as materiality and scienter are resolved through discovery and trial.** As demonstrated, p. 3, *supra*, one

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* *E.g.*, *Panzirer* v. *Wolf*, 663 F.2d 365 (2d Cir. 1981), *petition for cert. filed sub nom. Price Waterhouse* v. *Panzirer*, 50 U.S.L.W. 3883 (U.S. April 28, 1982) (No. 81-1998); *Wachovia Bank and Trust Co.* v. *National Student Marketing Corp.*, *supra*, 650 F.2d at 357; *Blackie* v. *Barrack*, *supra*, 524 F.2d at 907-908. One of the problems with this theory is that it "presumes," in addition, that all information is absorbed by a thoroughly efficient market and is reflected in the market price of a stock. Although market prices and fluctuations often are unrelated to published information and stem rather from whim, fear, euphoria, speculative excess and a host of other factors which have nothing to do with published fundamentals, *see, e.g.*, *Gulf & Western Industries, Inc.* v. *Great Atlantic & Pacific Tea Co.*, 356 F.Supp. 1066, 1071 (S.D. N.Y.), *aff'd*, 476 F.2d 687 (2d Cir. 1973), the courts which have adopted the theory have not yet ruled whether this additional "presumption" may be rebutted by evidence of such conditions or whether it will be treated as an irrebuttable "presumption."

** *E.g.*, *Green* v. *Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); *Arthur Young & Co.* v. *United States District Court*, 549 F.2d 686, 694-95 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977); *In re National Student Marketing Litigation*, M.D.L. No. 105 (D.D.C. Oct. 20, 1980) at pp. 3-6. Some had thought that the "presumption" of reliance, if it applied, could be rebutted at the pleadings stage in those cases where facts al-

court of appeals has held that if discovery from members of a class concerning causation, which would be necessary for the defendant to be in a position to rebut a "presumption" of reliance, becomes "time-consuming" then district courts might resort to "extensive powers to expedite the suit with procedural innovations" or "reconsider whether to make [the presumption] conclusive," *Blackie* v. *Barrack*, *supra*, 524 F.2d at 907 n.22.

Again, the contradictions and ambiguities stand in stark contrast to the precise standards supplied by Congress. Congress initially determined that proof of reliance was unnecessary in actions under § 11 of the 1933 Act but amended § 11(a) in 1934 "to require proof that the purchaser of a security at the time he acquired the security, relied upon the untrue statement in the registration statement or upon the registration statement and did not know of the omission" in certain specified cases, H.R. Conf. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934).* The amend-

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legedly omitted from a particular statement or report were elsewhere and readily available to the public. The thought was that members of the investor class either were aware of the facts and, accordingly, not deceived, or were barred from complaining they were deceived because of the apparent failure to exercise due diligence in discovering the available information. The courts have developed, however, "differing conclusions as to the degree of diligence appropriately required," *Dupuy* v. *Dupuy*, 434 U.S. 911 (1977) (White, J., dissenting from the denial of a writ of certiorari), and some courts have held that a question of fact necessarily exists because in order to foreclose a claim it must be shown that the investor acted with "recklessness" in failing to discover the available facts. *See, e.g., Dupuy* v. *Dupuy*, 551 F.2d 1005 (5th Cir. 1977), and *compare, e.g., Seibert* v. *Sperry Rand Corp.*, 586 F.2d 949, 952 (2d Cir. 1978); *Rodman* v. *Grant Foundation*, 460 F.Supp. 1028, 1035-36 (S.D.N.Y. 1978), *aff'd*, 608 F.2d 64 (2d Cir. 1979).

* In actions under §§ 11 and 12 of the 1933 Act, moreover, the scope of potential liability is easily assessed by reason of the nature of the remedies. Section 12(2) provides a remedy against the

ment was passed in conjunction with enactment of § 18 of the 1934 Act which provides that the plaintiff must plead and prove in all cases that he did not know "that such statement [contained in a report filed with the SEC] was false or misleading" and that a purchase or sale was made "in reliance upon such statement" (§ 18(a)). The plaintiff is entitled to recover "damages caused by such reliance" (*ibid.*). An early version of the bill which required only that the plaintiff be a person who purchased or sold a security at a price affected by an alleged misstatement was criticized in hearings because it permitted recovery of damages by persons "who have not relied upon the inaccurate or misleading statement" and by those who "trade recklessly." * Because of that criticism, the bill was redrafted and the requirement of actual reliance was added. As explained by Representative Sam Rayburn, then Chairman of the Committee on Interstate and Foreign Commerce:

> "The first provision of the bill as originally written was very much challenged on the ground that reliance should be required. This objection has been met." (78 Cong.Rec. at 7701 (1934))**

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seller who presumably is familiar with those to whom stock was sold. The remedy in § 11 is available to purchasers of a specified number of shares in registration. The 1934 amendment to § 11(a), set forth in text, provides a requirement of proof of reliance for subsequent purchasers in the secondary market of shares covered by the registration statement.

* *Stock Exchange Practices: Hearings on S.Res. 84, S.Res. 56 and S.Res. 97 Before Sen. Comm. on Banking and Currency*, 73d Cong., 2d Sess. at 6638, 7084 (1934) (*"1934 Senate Hearings"*); *Stock Exchange Regulation: Hearing on H.R. 7852 and 8720 Before House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. at 226, 656 (1934) (*"1934 House Hearing"*). *See also 1934 Senate Hearings* at 6939, 7186, 7567-68; *1934 House Hearing* at 262, 489.

** The suggestion by the court of appeals, 640 F.2d at 542, and other lower courts that a more rigid burden of proof of causation

Statute of Limitations—Failure to adhere to Congressional intent in respect of the statute of limitations element of a § 10(b) claim has resulted in additional permutations of the "implied" cause of action. The limitations period in § 10(b) litigation is "presently one of the more confused areas of federal law." *

It is generally held that actions under § 10(b) are governed by the statute of limitations of the forum state which applies to the cause of action available under the law of that state most analogous to an "implied" § 10(b) cause of action.** The limitations period depends on (i) the district

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is imposed under § 18 as a "trade-off" against the requirement in actions under § 10(b) that the plaintiff prove scienter, *e.g.*, *Wachovia Bank and Trust Co.* v. *National Student Marketing Corp.*, *supra*, 650 F.2d at 356-57, is pure fiction. Congress did not contemplate any remedy under § 10(b) and, therefore, did not address the question of causation in formulating its terms. Nor can it be maintained that there was a judicial "trade-off" because, as shown above, pp. 6n*, 14, courts have since 1972 applied a "presumption" of reliance in actions under § 10(b) whereas the scienter requirement was first imposed by the Court in *Hochfelder* in 1976.

* Note, *Limitation Borrowing in Federal Courts*, 77 Mich.L.Rev. 1127, 1137 (1979).

** *See Hochfelder*, 425 U.S. at 210 n.29. The Court noted in *Hochfelder* that the law of limitations of the forum state generally is applied in "cases of judicially implied remedies" (*ibid.*) where it may be assumed that Congress has "left matters for judicial determination," *Holmberg* v. *Armbrecht*, 327 U.S. 392, 395 (1946). In enacting the federal securities laws, however, Congress gave attention to the applicable limitations period with respect to each of the remedies that it contemplated. There is no reason to assume that Congress even considered that different limitations periods would be applied in any litigation under the 1933 or the 1934 Acts. *See McAllister* v. *Magnolia Petroleum Co.*, 357 U.S. 221, 229 (1958) (Brennan, J., concurring) (a state statute of limitations should be applied only "[i]n the absence of any comparable federal statute of limitations which might be applied"); *Occidental Life Insurance Co.* v. *EEOC*, 432 U.S. 355, 367 (1977) ("State limitations periods will not be borrowed if their application would be inconsistent with the underlying policies of the federal stat-

in which an action is instituted or, if the forum state has a "borrowing" statute (many states do), where the plaintiff resides or was injured and (ii) which of the limitations statutes of that state is found to be appropriate. The answers are hardly ever clear, *see, e.g.*, the three opinions in *Roberts* v. *Magnetic Metals Co.*, 611 F.2d 450 (3d Cir. 1979) (concerning a § 10(b) action instituted in New Jersey) and the two opinions in *Carothers* v. *Rice*, [1980] CCH Fed.Sec.L.Rep. ¶ 97,632 (6th Cir. 1980) (concerning a § 10(b) action instituted in Kentucky).

While Congress enacted a uniform statute of limitations applicable to each of the different express remedies under the 1933 Act and the 1934 Act—one year from discovery of the cause of action but no more than three years from the purchase or sale, § 13 of the 1933 Act, 15 U.S.C. § 77m (1976), §§ 9(e) and 18(c) of the 1934 Act—the courts have applied to § 10(b) local statutes of limitations ranging from two* to ten years.** The courts also have declined to impose any absolute limitation in actions under § 10(b), such as the three year limitation imposed by Congress. In actions under § 10(b), it is held, the limitations period runs only from discovery of facts underlying the complaint, and a question of fact arises in many cases concerning when

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ute."); *International Union, UAW* v. *Hoosier Cardinal Corp.*, 383 U.S. 696, 709 (1966) (White, J., dissenting) ("[T]he cases also establish that the silence of Congress is not to be read as automatically putting an imprimatur on state law. Rather, state law is applied only because it supplements and fulfills federal policy, and the ultimate question is what federal policy requires."). *See also Johnson* v. *Railway Express Agency, Inc.*, 421 U.S. 454, 462 (1975); *Board of County Commissioners* v. *United States*, 308 U.S. 343, 351-52 (1939).

* *E.g.*, *Vanderboom* v. *Sexton*, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970).

** *Denny* v. *Performance Systems, Inc.*, [1971-72] CCH Fed. Sec.L.Rep. ¶ 93,387 (M.D. Tenn. 1971).

the alleged recklessness of the defendant was or could have been discovered.*

This element of the "implied" § 10(b) cause of action most vividly illustrates the inefficiency of looking elsewhere than to explicit evidence of Congressional intent for definition of the scope of civil liability under the federal securities laws. Congress devoted considerable attention to the appropriate limitations period for the causes of action it contemplated. *E.g.*, an early version of the bill containing § 10(b) and express remedies in §§ 9 and 18 of the 1934 Act contained a provision barring any action unless brought within two years after discovery of the facts constituting the cause of action and six years after the cause of action accrued, S.Rep. No. 792, 73d Cong., 2d Sess. 23, 41 (1934). Senator Kean thought the two-year period "nothing but blackmail."

> "They discover it after the market has gone down, and after something has happened, and they are looking for mistakes. . . ." (*1934 Senate Hearings* at 6565)

See also 78 Cong. Rec. 8199 (remarks of Sen. Kean), 8198 (remarks of Sen. Fletcher), 8200 (remarks of Sen. Byrnes) (1934). The bill was revised to require that an action be brought within one year of discovery and no later than three years after accrual of the cause of action. As part of the same act passed in 1934, Congress also amended the 1933 Act to reduce the limitations period for actions under §§ 11 and 12 from two years from discovery and ten years from the purchase to one year and three years, H.R. Conf. Rep. No. 1838, *supra*, at 41-42.**

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* *See, e.g., Robertson* v. *Seidman & Seidman*, 609 F.2d 583 (2d Cir. 1979).

** In 1938 Congress amended § 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b) (1976), to subject it to the same one- and three-year limitations period. The same limitations period also applies in

Rather than apply the limitations period which Congress enacted, the courts have fostered litigation concerning which of several local statutes of limitations should be applied and when it should be deemed to commence running. As stated by the draftsmen of the American Law Institute's proposed *Federal Securities Code:*

> "The statutes of limitations that the courts have borrowed from state law frequently run longer than the statutes of limitations for the express actions created by Congress; they are highly diverse; and the result has been much wasteful litigation." 1 ALI, *Federal Securities Code* xliv-xlv (1980).*

The result, moreover, is entirely contrary to the policy of repose underlying all statutes of limitations, *see United States* v. *Kubrick*, 444 U.S. 111, 117 (1979):

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actions under § 16(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79p(a) (1976), and § 323(a) of the Trust Indenture Act of 1939, 15 U.S.C. § 77www(a) (1976), which also expressly impose civil liability for misleading statements.

The conclusion of the court of appeals that "limitations" contained in the express remedy provisions are not "impermissibly nullif[ied]" by the "implied" § 10(b) remedy because a plaintiff must prove scienter under § 10(b) (640 F.2d at 542), disproved above, pp. 6n*, 17n-18n**, fails in addition to account for the fact that Congress imposed a uniform limitations period on all express remedies including actions under, *e.g.*, § 9(e) where the plaintiff also must prove scienter.

* In addition, local laws are amended from time to time for reasons unrelated to federal concerns so that federal courts must reconsider the question of which local statute best effectuates federal policy. As the court stated in *McNeal* v. *Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888, 893 n.9 (5th Cir. 1979), "It is undeniably untidy to insist that the statute of limitations applicable to a federal cause of action vary from time to time dependent upon changes in local law." *See also Fox* v. *Kane-Miller Corp.*, 398 F.Supp. 609, 641 (D. Md. 1975), *aff'd*, 542 F.2d 915 (4th Cir. 1976) ("[I]t would seem that a federal court should not, because of subsequent changes in state statutory law, move its own federal 10b-5 limitations period up and down like a yo-yo on a string.").

> "Statutes of limitations, which 'are found and approved in all systems of enlightened jurisprudence,' *Wood* v. *Carpenter*, 101 U.S. 135, 139 (1879), represent a pervasive legislative judgment that it is unjust to fail to put the adversary on notice to defend within a specified period of time and that 'the right to be free of stale claims in time comes to prevail over the right to prosecute them.' *Railroad Telegraphers* v. *Railway Express Agency*, 321 U.S. 342, 349 (1944). These enactments are statutes of repose. . . ."

Indeed, Congress expressed its intention in 1934 that a uniform statute of limitations should be applied in litigation under the federal securities laws to enhance the policy of repose and to avoid the very condition which has resulted.

> "[W]e were fearful that it might bring about an absurd condition, in that the laws of some States might allow an action at a much later date than other laws, and even if the action were brought in the Federal courts, following the local practices with regard to limitations might result in varied rules of law as to the liability. We feel that it should be made definite or certain one way or the other." *

The present condition, PMM submits, in fact is "absurd." For example, in New York where much of the litigation under the federal securities laws is instituted the local statute of limitations applicable to common law actions for fraud is applied to § 10(b)—six years from the purchase or sale and two years from discovery.** That is the same limitations period explicitly rejected by Congress, *see* p.

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* Remarks of Senator Redmond, *1934 Senate Hearings* at 7561.

** New York C.P.L.R. §§ 203(f), 213(8) (McKinney Supp. 1981-82). *See Klein* v. *Auchincloss, Parker & Redpath*, 436 F.2d 339 (2d Cir. 1971).

20, *supra*. The choice provided under the law of most states between the limitations provision contained in the local securities or "blue sky" law and the limitations period applicable in actions at common law for fraud* is not available because the New York blue sky statute contains no express private damage remedy and, accordingly, no statute of limitations.

A twist is added, moreover, since New York has a "borrowing" statute which requires the court to look to the law of the state where the alleged "injury was felt," in actions instituted by out-of-state plaintiffs, if that state has a shorter statute of limitations.** Federal courts sitting in New York are in some cases required to make decisions concerning which of several state statutes of limitations of any of 50 states might apply.*** The courts have thrown up their hands concerning limitations issues which arise in large class actions.****

Judicial recognition of an "implied" private remedy under § 10(b) has proven a mistake. Litigation under

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* Note, *Limitation Borrowing in Federal Courts, supra*, 77 Mich. L. Rev. at 1137.

** *See Arneil* v. *Ramsey*, 550 F.2d 774, 780 (2d Cir. 1977); New York C.P.L.R. § 202 (McKinney 1972).

*** *See, e.g., Berry Petroleum Co.* v. *Adams & Peck*, 518 F.2d 402 (2d Cir. 1975) (Texas); *Posner* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.Supp. 972, 981-82 (S.D.N.Y. 1979) (Arkansas); *Robertson* v. *Seidman & Seidman*, [1978] CCH Fed. Sec.L.Rep. ¶ 96,420 (S.D.N.Y. 1978), *rev'd*, 609 F.2d 583 (2d Cir. 1979) (Alaska); *Brick* v. *Dominion Mortgage & Realty Trust*, 442 F.Supp. 283 (W.D.N.Y. 1977) (New Jersey).

**** *See State Teachers Retirement Board* v. *Fluor Corp.*, 80 F.R.D. 142 (S.D.N.Y. 1978); *Robertson* v. *Seidman & Seidman*, 79 Civ. 3271 (RWS) at n.7 (S.D.N.Y. May 23, 1980); *In re National Student Marketing Litigation*, [1981] CCH Fed. Sec.L. Rep. ¶ 97,926 at 90,709-710 (D.D.C. 1981).

§ 10(b) has involved primarily an expensive and unsuccessful effort to resolve what are academic questions concerning the elements of the cause of action. The process and the contradictions and ambiguities which have resulted are unnecessary, PMM submits, because clear answers are provided in the remedial provisions enacted by Congress.

To deny the existence of an "implied" private cause of action under § 10(b) when the conduct alleged is the subject of an express cause of action would not foreclose relief to investors. Rather it would in one sweep define with precision, in such cases at the very least, when relief is available in federal courts and thereby encourage consideration of the merits of claims of entitlement to relief.

CONCLUSION

The decision of the court of appeals should be reversed.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

HERMAN & MACLEAN, PETITIONER

v.

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR.

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR., PETITIONERS

v.

HERMAN & MACLEAN, LAWRENCE A. LOPATIN, and LESLIE SHARE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE IN SUPPORT OF PARTIAL AFFIRMANCE

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QUESTIONS PRESENTED

1. Whether Section 11 of the Securities Act of 1933, which provides an express remedy for misrepresentations in registration statements filed under that Act, precludes defrauded purchasers of registered securities from maintaining an action under Section 10(b) of the Securities Exchange Act of 1934.

2. Whether persons seeking recovery under Section 10(b) must prove their cause of action by clear and convincing evidence rather than by a preponderance of the evidence.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 81-680

HERMAN & MACLEAN, PETITIONER

v.

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR.

No. 81-1076

RALPH E. HUDDLESTON and CHESTER E. BRADLEY, JR., PETITIONERS

v.

HERMAN & MACLEAN, LAWRENCE A. LOPATIN, and LESLIE SHARE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE IN SUPPORT OF PARTIAL AFFIRMANCE

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is responsible for administering and enforcing the federal securities laws. It frequently has appeared before this Court as amicus curiae in cases brought by private parties under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b).

STATEMENT

The class action complaint in this case alleges violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), as well as SEC Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5. The complaint was brought by purchasers of the securities of Texas International Speedway, Inc. ("TIS"), which were issued pursuant to a registration statement filed under the Securities Act. The plaintiff class consists of persons who received a prospectus and purchased TIS securities either in the initial offering or in the subsequent over-the-counter market. Plaintiffs sued most of the participants in the offering, including the accounting firm, Herman & MacLean, which issued an opinion concerning certain financial statements and a pro forma balance sheet included in the registration statement and prospectus.

Plaintiffs alleged that the defendants engaged in a scheme to misrepresent and conceal material facts regarding the financial condition of TIS. They claimed, *inter alia*, that Herman & MacLean conspired with other defendants to understate certain construction costs of TIS as reflected in a pro forma balance sheet, which was the subject of Herman & MacLean's opinion, and in the "Use of Proceeds" portion of the registration statement and prospectus, which was not covered by that opinion. Following a three-week trial, the jury found that Herman & MacLean and certain other defendants had violated and aided and abetted violations of Section 10(b) (81-680 Pet. App. A-2 to A-4).

The court of appeals affirmed the district court's ruling that a cause of action may be maintained under Section 10(b) for fraudulent misrepresentations and omissions even though that conduct "apparently" would provide the basis for a remedy under Section 11 of the Securities Act of 1933, 15 U.S.C. 77k (Pet. App. A-5 to A-11). However, the court of appeals disagreed with

the district court on the appropriate standard of proof, concluding that proof by "clear and convincing" evidence is required in a case of this kind (*id.* at A-16 to A-18). The court of appeals set aside the district court's judgment on other grounds and remanded the case for a new trial (*id.* at A-47).

SUMMARY OF ARGUMENT

1. The decisions of this Court clearly confirm the existence of an implied private remedy under Section 10(b) of the Securities Exchange Act. See, *e.g.*, *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, No. 80-203 (May 3, 1982), slip op. 35 n.88. That private remedy accords with this Court's current standards for analyzing implied rights of action. Congress recognized and affirmed the private remedy under Section 10(b) when it comprehensively amended the Securities Exchange Act in 1964 and 1975. Prior to enacting those amendments, Congress specifically considered the availability of a private remedy under Section 10(b) and it took action to complement, rather than undermine, that remedy. This constitutes legislative ratification of the private right of action. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, *supra*, slip op. 28. Beyond this, the existence of a private remedy under Section 10(b) finds additional support in a straightforward application of the four-factor test enunciated by this Court in *Cort* v. *Ash*, 422 U.S. 66 (1975).

This well-established private remedy under Section 10(b) supplements the express remedy available to purchasers of registered securities under Section 11 of the Securities Act. This Court so concluded in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976). In that case, the Court recognized that implied remedies under Section 10(b) overlap express remedies under Section 11. It accordingly required proof of scienter in Section 10(b) suits to avoid nullifying certain procedural restrictions that apply in actions under Section 11. The substantial

additional burdens assumed by the Section 10(b) plaintiff—including proof of scienter—avoid any possibility of displacing the Section 11 remedy or its procedural limitations.

Restricting defrauded purchasers in a registered offering to whatever remedy may be available under Section 11 would create serious gaps in the protection available to such persons. Section 10(b), unlike Section 11, reaches all varieties of fraudulent conduct practiced by "any person" in a registered offering. Moreover, Congress announced the intent to make the federal securities laws "complete and effective" (15 U.S.C. 78b). It declared unequivocally that the express remedies in the Securities Act are "in addition to," rather than in derogation of, "any and all other rights and remedies that may exist at law or in equity" (15 U.S.C. 77p). Congress did not intend that Section 11, a provision designed to afford purchasers in registered offerings with special protections unavailable at common law, would serve to restrict alternative remedies available to all purchasers who prove actual fraud.

2. The traditional preponderance of the evidence standard of proof applies in civil actions brought under the antifraud provisions of the federal securities laws, as this Court held in *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). The decision of the court of appeals in this case is the only appellate decision imposing a clear and convincing evidence standard under the securities laws. And it is contrary to the better reasoned decisions in common law fraud cases, which approve the preponderance standard.

The preponderance standard comports with the principles set forth by this Court in *Addington* v. *Texas*, 441 U.S. 418 (1979). *Addington* holds that the standard of proof must rest on a careful balancing of the interests of the opposing litigants. Where, as here, the interests of the party charged with fraud do not outweigh the interests of the class of investors that Congress intended

to protect, this Court should not adopt a standard of proof that would shift the risk of factual error to those investors. Indeed, to tip the risk of error so decidedly against the investors whom Congress intended to protect would seriously undermine the fundamental purpose of this legislation.

ARGUMENT

I. SECTION 11 OF THE SECURITIES ACT, WHICH PROVIDES AN EXPRESS PRIVATE REMEDY AGAINST SPECIFIED PERSONS FOR NEGLIGENT AND INNOCENT MISSTATEMENTS AND OMISSIONS IN REGISTERED SECURITIES OFFERINGS, DOES NOT RESTRICT THE AVAILABILITY OF A REMEDY UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT, WHICH BROADLY PROHIBITS ALL PERSONS FROM ENGAGING IN FRAUDULENT CONDUCT IN CONNECTION WITH ANY PURCHASE OR SALE OF SECURITIES

Herman & MacLean, the petitioner in No. 81-680, contends that, because this case involves a registered securities offering, and because Section 11 of the Securities Act provides a private remedy for misstatements in a prospectus used in a registered offering, a private remedy under Section 10(b) of the Securities Exchange Act is unavailable (Br. 19-28). While this Section 11 preemption issue is the question on which certiorari was granted, certain of Herman & MacLean's arguments go beyond that issue and suggest that there should be no implied private right of action under Section 10(b) at all (Br. 9-12, 19, 25-27). Accordingly, we briefly address the question of the availability of a Section 10(b) private right of action and then turn to the Section 11 preemption issue.[1]

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[1] The plaintiffs in this case also sought relief under Section 17(a) of the Securities Act. This Court has reserved decision on the question whether Section 17(a) affords a private remedy. *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 557 n.9 (1979). It should do so once again in this case. The courts

A. A Private Right Of Action Exists For Violations Of Section 10(b) of the Securities Exchange Act

Since *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), the federal courts uniformly have recognized a private right of action under Section 10(b). Today, the Section 10(b) remedy stands as a cornerstone of the federal effort to ensure honesty in securities transactions and provides essential support for public confidence in the nation's securities markets and the capital formation process. Given the limited enforcement resources of the Commission, the private right of action is vital to effective enforcement of Section 10(b).

All of the federal courts of appeals have sustained this private remedy.[2] And this Court, in no less than seven decisions handed down since 1971, has reaffirmed the existence of the implied right under Section 10(b). See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, No. 80-203 (May 3, 1982), slip op. 26, 35 n.88, 37 n.92, 41; *Aaron* v. *SEC*, 446 U.S. 680, 689 (1980); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 577 n.19 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677, 692 n.13 (1979); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 196 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Superintendent of In-*

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below found that plaintiffs presented adequate proof of scienter (see Pet. App. A-14 to A-19), and Herman & MacLean has not sought review of that factual determination. In these circumstances, any relief available under Section 17(a) also is available under Section 10(b). It accordingly is unnecessary to reach the question whether a separate cause of action arises under Section 17(a). See *Schaefer* v. *First National Bank*, 509 F.2d 1287, 1293 (7th Cir. 1975). It would be particularly inappropriate to reach that issue here because the court of appeals did not address it. Indeed, the plaintiffs appear to have abandoned any separate claim under Section 17(a) (see Br. 4 n.6).

[2] See VI L. Loss, *Securities Regulation* 3871-3873 (2d ed. Supp. 1969) (collecting cases); *Wachovia Bank & Trust Co.* v. *National Student Marketing Corp.*, 650 F.2d 342, 353 (D.C. Cir. 1980), cert. denied, 452 U.S. 954 (1981).

surance v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); see also *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 144-157 (1972); *Tcherepnin* v. *Knight*, 389 U.S. 332, 334, 345-346 (1967). This Court relied on the great weight of this judicial authority in its opinion in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, *supra*, which held that the analogous antifraud provision of the Commodity Exchange Act gives rise to an implied remedy. The Court upheld that private remedy even though "the consensus of opinion concerning the existence of a private cause of action under the CEA was neither as old nor as overwhelming as the consensus concerning § 10(b) * * *" (slip op. 26). It would be fundamentally inconsistent with the *Curran* decision now to reject a private remedy under Section 10(b).

Because the private right of action under Section 10(b) is so well rooted in federal jurisprudence, this Court need not inquire whether that right is congruent with recent decisions evaluating other implied remedies. See *Touche Ross & Co.* v. *Redington*, *supra*, 442 U.S. at 577 n.19; *Cannon* v. *University of Chicago*, *supra*, 441 U.S. at 692 n.13. Contrary to Herman & MacLean's suggestion, however, the implied right under Section 10(b) is not a historical anachronism. Rather, the private remedy under Section 10(b) conforms in all respects with this Court's recent decisions.

1. The "central inquiry" in deciding whether a private remedy may be implied is congressional intent. *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 23 (1979). But that inquiry differs depending on whether a court considers new legislation or, as in the case of the Securities Exchange Act, legislation that Congress amended following its enactment. As stated by the Court in *Curran* (slip op. 24):

> When Congress enacts new legislation, the question is whether Congress intended to create a private

> remedy as a supplement to the express enforcement provisions of the statute.

By contrast,

> [w]hen Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts * * * the inquiry logically is different. Congress need not have intended to create a new remedy, since one already existed; the question is whether Congress intended to preserve the pre-existing remedy.

Id. at 24-25.

In *Curran*, this Court found that when Congress "comprehensively reexamined and strengthened" the Commodity Exchange Act in 1974 (slip op. 24), federal courts consistently had recognized an implied right of action under that statute (*id.* at 25-26). Accordingly, the implied right stood as part of the "contemporary legal context" in which Congress acted in 1974. And the fact that the 1974 amendments "left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy." *Id.* at 28 (footnote omitted). The *Curran* rationale applies here. Congress comprehensively amended the Securities Exchange Act in 1964 and 1975 without disturbing the uniform judicial recognition of an implied private remedy under Section 10(b). " 'The statutes originally enacted in 1933 and 1934 have been amended so often with full congressional awareness of the judicial interpretation of [Section 10(b) and] Rule 10b-5 as implicitly creating a private remedy that we must now assume that Congress intended to create rights for the specific beneficiaries of the legislation * * *' " (slip op. 37 n.92).

The Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565, resulted from a congressionally mandated Special Study conducted by the Commission, which reported to Congress that Section 10(b) and Rule

10b-5 applied to over-the-counter as well as listed securities and that "the courts have almost uniformly held that they create a private right of action" (*Report of Special Study of Securities Markets of the Securities and Exchange Commission*, H.R. Doc. No. 95 (Pt. 3), 88th Cong., 1st Sess. 95-96 (1963)). The Study recommended, however, that Congress strengthen over-the-counter regulation (*id.* at 62-64). Congress did so. But, consistent with the Commission's report, it left undisturbed the private right of action recognized under Section 10(b).

More recently, Congress enacted the Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97. Congress thus undertook the "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934."[8] When Congress engaged in this comprehensive reexamination and amendment of the securities laws, an implied cause of action under Section 10(b) was a conspicuous element of the "contemporary legal context." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, *supra*, slip op. 27. As part of the 1975 amendments, Congress enacted Section 21(g) of the Securities Exchange Act, 15 U.S.C. 78u(g), which prohibits consolidation of Commission injunctive actions with private actions in the absence of Commission consent. That provision overturned lower court decisions that ordered such consolidation with private actions, including actions brought under Section 10(b). See S. Rep. No. 94-75, 94th Cong., 1st Sess. 75-77 (1975) (citing those decisions). Significantly, while Congress refused to permit consolidation of private actions with governmental enforcement actions, it did not otherwise restrict the private remedy. Indeed, it was largely because of its recognition that there was a private Section 10(b) remedy that Congress found it necessary to enact Section 21(g).

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[8] *Securities Acts Amendments of 1975: Hearings on S. 249 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. 1 (1975).

In 1977, Congress enacted the Foreign Corrupt Practices Act, Pub. L. No. 95-213, 91 Stat. 1494, to amend the Securities Exchange Act. The House Committee Report contemplated private redress under the 1977 amendments as "in implied private actions brought under the securities laws generally." H.R. Rep. No. 95-640, 95th Cong., 1st Sess. 8 (1977). The Report explained (*id.* at 10):

> The Committee intends that the courts shall recognize a private cause of action based on this legislation, as they have in cases involving other provisions of the Securities Exchange Act, on behalf of persons who suffer injury as a result of prohibited [practices]. The recognition of such a private cause would enhance the deterrent effect of this legislation and provide a necessary supplement to the enforcement efforts of the Commission and the Department of Justice.

The same Report expressed Congress' understanding (*ibid.*) that "private plaintiffs" may bring suit "to recover monetary damages for violations of Securities Exchange Act Rule 10b-5 * * *."

2. Implication of a private remedy under Section 10(b) on behalf of securities purchasers also agrees with the four-part test prescribed in *Cort* v. *Ash*, *supra*, 422 U.S. at 78. There can be no serious dispute that the first, third, and fourth parts of that test call for an implied remedy.[4] And, with respect to the second *Cort* factor,

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[4] Section 10(b) prohibits fraudulent conduct in connection with the "purchase or sale" of securties for "the protection of investors." Thus, purchasers and sellers are the special beneficiaries of the provision. *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 733-734. Moreover, as in *Curran*, "the private cause of action enhances the enforcement mechanism fostered by Congress" (slip op. 33). It compensates protected parties victimized by fraud and deters misconduct that Congress has condemned. Finally, the private remedy under Section 10(b) does not involve issues relegated exclusively to state law. Congress viewed prevention of fraud in securities purchases and sales as a matter of "national public

there is no hint of a congressional intent to deny a private remedy under Section 10(b). The situation here therefore differs fundamentally from *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, *supra*. In that case, this Court found an intent to deny a damage remedy under Section 206 of the Investment Advisers Act because Congress had provided no express damage remedies at all and because it had rejected statutory language extending federal court jurisdiction to "actions at law" brought to enforce any "liability" created by the Act. 444 U.S. at 20-22. By contrast, as this Court recognized in *Transamerica*, the Securities Exchange Act provides express damage remedies under several provisions.[5] It also grants federal court jurisdiction over "actions at law" to enforce statutory "liabilit[ies]." Section 27, 15 U.S.C. 78aa. Moreover, when Congress enacted the Securities Exchange Act in 1934, federal courts consistently had held that statutory violations injuring a protected party supported an implied remedy. See *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33, 39-40 (1916). "Under this approach, federal courts, following a common-law tradition, regarded the denial of a remedy as the exception rather than the rule." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, *supra*, slip op. 21. Since "'[i]t is always appropriate to assume that our elected representatives, like other citizens, know the law'" (*id.* at 25), it is perfectly reasonable to assume that Congress recognized the *Rigsby* principle when it enacted Section 10(b).

B. The Implied Private Right Of Action Under Section 10(b) Of The Securities Exchange Act Is Not Preempted By The Express Remedy Prescribed In Section 11 Of The Securities Act

1. Herman & MacLean argues (Br. 37) that, whatever the general availability of an implied right of action

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interest" (15 U.S.C. 78b). It adopted this legislation because state law had failed adequately to curb injurious practices in securities transactions.

[5] See note 15, *infra*.

under Section 10(b), a purchaser in a registered securities offering cannot maintain such an action because of the existence of an express remedy under Section 11. Herman & MacLean views the many decisions of this Court that recognize the general availability of a private right under Section 10(b) as leaving open this "preemption" issue. To the contrary, however, the very rationale utilized in those decisions, as well as this Court's reasoning in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), foreclose this line of argument.

As noted above, this Court has upheld the private remedy under Section 10(b) in view of the longstanding uniform recognition of such a remedy by the federal courts. This Court's rationale provides no basis for carving out a particular type of fraudulent conduct covered by the literal terms of Section 10(b)—such as fraud occurring in a registered offering. In fact, the federal courts with virtual unanimity have rejected the notion that the availability of an express remedy precludes maintenance of an implied cause of action. For example, defrauded purchasers of securities have brought the great bulk of suits instituted under Section 10(b), even though Section 12(2) of the Securities Act, 15 U.S.C. 77*l*(2), prescribes an express private right of action for purchasers. Similarly, many Section 10(b) actions have arisen from fraudulent conduct associated with registered offerings.[6] And since at least 1951, the federal courts of appeals consistently have rejected the contention that express private remedies, such as the Section 11 remedy, are exclusive, and have reaffirmed that the implied remedy under Section 10(b) is cumulative.[7]

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[6] See 1 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud* §§ 2.4(210), 2.4(410) (1982) (collecting cases).

[7] See *Wachovia Bank & Trust Co.* v. *National Student Marketing Corp.*, 650 F.2d 342, 354-359 (D.C. Cir. 1980), cert. denied, 452 U.S. 954 (1981); *Ross* v. *A.H. Robins Co.*, 607 F.2d 545, 551-556 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); *Schaefer* v. *First National Bank*, 509 F.2d 1287, 1292-1293 (7th Cir. 1975), cert. denied, 425 U.S. 943 (1976); *Wolf* v. *Frank*, 477 F.2d 467, 475 (5th

That consistent line of decisions agrees with this Court's repeated recognition that the antifraud provisions of the securities laws overlap to a substantial degree and that "the [Securities and Securities Exchange] Acts prohibit some of the same conduct." Thus, "[t]he fact that there may well be some overlap is neither unusual nor unfortunate." *United States* v. *Naftalin*, 441 U.S. 768, 778 (1979), quoting *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969).[8] That line of decisions also provides an unequivocal rule of judicial interpretation of Section 10(b) that Congress left undisturbed when it comprehensively amended the Securities Exchange Act. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran, supra*, slip op. 28 & n.66: "Congress is presumed to be aware of [a] * * * judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change * * *." See also *Rubin* v. *United States*, 449 U.S. 424, 430 (1981); *Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978). Thus, for the same reason that Congress' reexamination and amendment of the securities laws serves to ratify the existence of a private right of action under Section 10(b), it also serves to ratify a conspicuous and uniformly accepted characteristic of that right of action—its cumulative and supplemental nature.

Cir.), cert. denied, 414 U.S. 975 (1973); *Gilbert* v. *Nixon*, 429 F.2d 348, 355 (10th Cir. 1970); *Jordan Building Corp.* v. *Doyle, O'Connor & Co.*, 401 F.2d 47, 51 (7th Cir. 1968); *Ellis* v. *Carter*, 291 F.2d 270, 273-274 (9th Cir. 1961); *Matheson* v. *Armbrust*, 284 F.2d 670, 674 (9th Cir. 1960), cert. denied, 365 U.S. 870 (1961); *Fratt* v. *Robinson*, 203 F.2d 627, 632 (9th Cir. 1953); *Fischman* v. *Raytheon Manufacturing Co.*, 188 F.2d 783, 786-787 (2d Cir. 1951). For citations to the multitude of district court decisions reaching the same result, see 1 A. Bromberg & L. Lowenfels, *supra*, §§ 2.4(200)-2.4(240), and 2.4(400)-2.4(445).

[8] In *Naftalin*, this Court applied Section 17(a) of the 1933 Act to conduct prohibited by Section 10(b) of the 1934 Act. In *National Securities*, it found substantial overlap between Sections 10(b) and 14(a) of the 1934 Act. In each instance, the Court firmly rejected "preemption" and "exclusivity" arguments raised by the defendants.

Moreover, this Court's holding in *Ernst & Ernst* v. *Hochfelder*, *supra*, rested in part on the premise that the implied remedy under Section 10(b) is cumulative of, rather than preempted by, the express remedies of the Securities Act. *Hochfelder* held that actions under Section 10(b) depend on proof of scienter, and do not encompass negligent conduct. The overlap between Section 10(b) and Sections 11 and 12(2) of the Securities Act provided an important ground for that holding. Precisely because conduct actionable under Sections 11 and 12(2) also is actionable in a private suit under Section 10(b), adoption of a negligence standard under Section 10(b) would (425 U.S. at 210)

> allow causes of action covered by §§ 11 [and] 12(2) * * * to be brought instead under § 10(b) and thereby nullify the effectiveness of the carefully drawn procedural restrictions on these express actions.[9]

Thus, essential to the Court's analysis in *Hochfelder* was the principle that neither Section 11 nor Section 12(2) restricts the availability of a private right under Section 10(b). To the contrary, the substantial overlap among these sections provided a compelling reason for requiring a higher culpability standard under Section 10(b).

2. Even if the Section 11 preemption issue were still an open question, Herman & MacLean has failed to sustain its burden of demonstration that this Court and the courts of appeals have misunderstood Congress' intent. Herman & MacLean contends that the plaintiffs in this case may not sue under Section 10(b) because they had a remedy under Section 11. It points to the fact that, by suing under Section 10(b), plaintiffs have avoided certain procedural and substantive limitations of Section 11. Herman & MacLean concludes (Br. 19-27) that it would be contrary to Congress' intent if a purchaser of

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[9] We discuss the procedural restrictions applicable to suits under Section 11 on pages 17, 19-20, *infra*.

registered securities ever were permitted to escape these procedural and substantive restraints.

Thus, Herman & MacLean's sweeping argument is not just that Section 10(b) is unavailable when Section 11 provides full relief—that is, when Section 10(b) serves only to afford the plaintiff greater procedural benefits. Herman & MacLean goes much further, arguing that Section 10(b) is unavailable even when, because of the limited coverage of Section 11, relief is totally unavailable under that provision. Neither assertion has a valid basis.

a. There is no evidence that Congress intended the express remedy of Section 11 to provide the exclusive method of recovery for investors defrauded in a registered securities offering. Indeed, Section 16 of the Securities Act, 15 U.S.C. 77p, supplies unequivocal evidence that Congress did not view the Section 11 remedy as "exclusive," and that it deliberately rejected the doctrine of expressio unius est exclusio alterius. In that section, Congress stated that "[t]he rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." Section 28(a) of the Securities Exchange Act, 15 U.S.C. 78bb(a), contains a parallel provision ("[t]he rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity"). Congress could hardly have enunciated its intent on the exclusivity issue in clearer terms. These provisions establish that Congress expected that express remedies, such as the remedy prescribed in Section 11, would not preempt other available remedies. Rather, Congress intended the express remedies to be supplemented by "any and all" additional remedies, including implied remedies recognized under federal law.

Beyond this, Congress declared the purpose, as set forth in Section 2 of the Securities Exchange Act, 15 U.S.C. 78b, "to impose requirements necessary to make

[securities] regulation and control reasonably complete and effective * * *." To hold, as Herman & MacLean urges, that the Section 11 remedy is exclusive would clash with Congress' objective of "complete" protection against fraud. Because of various limitations on the scope of Section 11, discussed on pages 19-20, *infra*, such a restrictive interpretation would produce serious gaps in the coverage of the antifraud provisions. As a consequence, some participants in fraudulent securities offerings would escape liability no matter how egregious and flagrant their misconduct. Thus, as stated by the Ninth Circuit in *Ellis* v. *Carter*, *supra*, 291 F.2d at 274, affording a remedy under Section 10(b) despite the existence of Section 11

> gives controlling weight to what seems to have been the dominant policy of Congress to provide complete and effective sanctions, public and private, with respect to the duties and obligations imposed under the [Securities and Securities Exchange] Acts.

Contrary to Herman & MacLean's contention, Congress did not impose limitations and restrictions on Section 11 to exclude other remedies or to insulate from private actions persons or conduct falling outside its scope. Rather, Congress narrowed the reach of Section 11 because of its appreciation of the greatly expanded liability imposed by that Section. Section 11 sought to assure compliance with the disclosure provisions of the Securities Act by imposing liability substantially beyond that imposed at common law on persons principally responsible for the disclosure requirements contained in the Act.[10] Section 11 permits any person acquiring a security to sue certain enumerated defendants if any part of a registration statement covering such security, on its effective date, was false or misleading. The plaintiff need only show a material misstatement. He need not prove scienter, or any other form of culpability. Section 11 imposes

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[10] See H.R. Rep. No. 85, 73d Cong., 1st Sess. 9-10 (1933); S. Rep. No. 47, 73d Cong., 1st Sess. 4-5 (1933).

absolute liability on issuers even for innocent misstatements in the registration statement. And other defendants bear the burden of proving the absence of negligence. The law presumes that a material misstatement caused financial injury. A plaintiff may recover unless he knew of the misstatement prior to his purchase.

Because this unprecedented remedy under Section 11 favored plaintiffs so substantially, Congress did not extend the remedy to all conduct or to all persons involved in a registered offering. Congress restricted liability to the issuer and to those persons primarily responsible for the preparation of a registration statement—*i.e.*, the issuer's directors, its principal executive, financial and accounting officers, the underwriters, and any experts who vouch for a portion of the registration statement. Congress also imposed procedural restrictions to prevent abuse of this potent remedy. Section 11(e), 15 U.S.C. 77k(e), authorizes a court, in its discretion, to require a plaintiff to post a bond for costs, and Section 13, 15 U.S.C. 77m, contains a short statute of limitations.

Section 10(b), unlike Section 11, requires the plaintiff to bear the burden of proving scienter, causation, and damages (see page 21, *infra*). It therefore does not represent the same extensive departure from the common law. Thus, Congress' rationale for imposing certain restrictions on the liberal Section 11 remedy does not apply in the Section 10(b) context. Moreover, the very existence of the Section 11 restrictions makes that provision a limited remedy and negates any contention that Congress viewed Section 11 as a complete substitute, in the case of registered offerings, for the private remedy under Section 10(b)—which reaches "any deceptive device in the 'sale' of any security by 'any person.'" *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 10.[11]

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[11] Herman & MacLean contends (Br. 13-18) that, notwithstanding the unambiguous language used by Congress, Section 10(b) applies only to "new manipulative devices" of the type specified in Sections

The *Curran* case illustrates this point. There, this Court considered whether an implied remedy existed under a general antifraud provision of the Commodity Exchange Act. That Act contains two express liability provisions under which commodity traders might seek some relief for violations of the Act. Notwithstanding the existence of those express remedies, this Court upheld an implied cause of action. It pointed, among other things, to the limitations Congress placed on the express remedies, including limits on the categories of persons subject to liability. The Court reasoned that these express remedies "do not substitute for the private remedy either as a means of compensating injured traders or as a means of enforcing compliance with the statute." Slip op. 30. This reasoning applies fully here. Section 11 provides a liberal remedy in certain limited situations but does not substitute for the general implied remedy under Section 10(b), which affords complete relief when the plaintiff proves deception, scienter, causation, and damages.[12]

9(a) and 10(a) of the Securities Exchange Act. But the legislative history upon which it relies relates to an earlier version of Section 10(b) that was limited to "manipulative" devices employed in connection with exchange-listed securities. As explained in *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 201-206, Congress broadened the statute before enactment to reach "*any* manipulative or *deceptive device or contrivance*" (emphasis added). It expressly reaches not only exchange-listed securities but also "any security not so [listed]." Thus, in any case involving "fraud," as opposed to negligence, "Section 10(b) is aptly described as a catchall provision." *Chiarella* v. *United States*, 445 U.S. 222, 234-235 (1980).

[12] Herman & MacLean relies (Br. 25-27) on certain decisions of this Court finding that express statutory remedies reflect a legislative intent that additional remedies not be recognized. But this Court also has emphasized that express remedies do not by themselves negate additional implied remedies. See *Cannon* v. *University of Chicago*, *supra*, 441 U.S. at 711; *Cort* v. *Ash*, *supra*, 422 U.S. at 83 n.14. The decisions cited by Herman & MacLean are inapposite where, as here, the question is whether a well-established private remedy under Section 10(b) should be denied to defrauded purchasers in a registered offering who complain of conduct that falls

b. Because the scope of Section 11 is narrower than that of Section 10(b) in certain important respects, a holding that Section 11 is the exclusive remedy for purchasers of securities in a registered offering would create an unwarranted anomaly. Persons purchasing securities outside of a registered offering would, in many respects, receive greater protection against fraudulent practices than similarly situated purchasers in a registered offering. That would turn the scheme of statutory protection on its head. The entire thrust of the Securities Act of 1933 is to enhance the protection afforded to purchasers in registered offerings.

Under Herman & MacLean's restrictive theory, purchasers in registered offerings, who would be required to rely solely on Section 11, would face numerous limitations inapplicable to purchasers seeking relief in other contexts. For example, under Section 11, experts are liable only with respect to those reports or statements, included in the registration statement, which purport to have been prepared or certified by them. Under Section 10(b), by contrast, an expert can be liable for falsifying other portions of the registration statement—a type of fraudulent conduct alleged by the plaintiffs here. In addition, Section 11 restricts the categories of persons liable for damages to those persons enumerated in the statute. Section 10(b), by contrast, extends to "any person" who engages in fraud in connection with a purchase or sale of securities.

Other significant restrictions exist under Section 11 but not under Section 10(b). A plaintiff may seek relief under Section 11 only with respect to securities covered by the registration statement, even though he may have been induced to purchase previously outstanding securities of the same or a different class by intentional misstatements in that document. Similarly, a plaintiff receives no protection under Section 11 for oral misrepresentations,

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squarely within the literal prohibition of the statute. Moreover, as noted above, Congress explicitly rejected the "expressio unius" doctrine in both of the statutes now before the Court.

or for deceptive promotional literature not included in the registration statement.[13] Section 10(b) protects securities purchasers in all of these situations.

Thus, if Herman & MacLean's argument were accepted, and Section 11 were deemed the sole remedy for purchasers in a registered offering, it would follow that defrauded purchasers who bought outside the context of a registered offering would receive the comprehensive protection of Section 10(b), while similarly situated purchasers in a registered offering would have no comparable protection. Such a result would convert a statutory provision intended to expand available remedies into a provision sharply restrictive of them. Nothing in the language or legislative history of the securities laws supports that result.

c. Finally, a holding that express remedies restrict the availability of remedies under Section 10(b) would impose on the federal judiciary burdensome, time-consuming, and unwarranted tasks in private actions brought under Section 10(b). It would force the trial judge to make a detailed comparison at the threshold of the litigation concerning the relief available to the plaintiff against each of the defendants under each potentially applicable statutory provision. And, in contrast to the present case, where the facts have been fully developed following a trial, the trial judge generally would be required to make that analysis on the basis of the pleadings. As is evident from the many differences between the Section 11 and Section 10(b) remedies, courts would be required to resolve a myriad of difficult issues in making this threshold determination.[14]

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[13] While Section 12(2) of the 1933 Act, 15 U.S.C. 77*l*(2), provides additional remedies for purchasers in registered offerings, it too applies only to a limited category of defendants. Unlike Section 10(b), it does not extend to "any person" who defrauds the purchaser.

[14] For example, before concluding that a Section 11 remedy is potentially available, the district court would have to find that the shares purchased by the plaintiffs were covered by and traceable

This burden on efficient judicial administration is not needed to protect defendants against unwarranted imposition of liability. Section 10(b) and Rule 10b-5 are perhaps "the most litigated provisions in the federal securities laws." *SEC* v. *National Securities, Inc., supra*, 393 U.S. at 465. Accordingly, this Court has had occasion to define the elements of a private cause of action under Section 10(b) with substantial clarity, prescribing standards that provide defendants with meaningful protection. It has carefully defined the nature of prohibited deceptive practices (*Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *Chiarella* v. *United States, supra*); has limited the class of persons who may bring suit to avoid nuisance litigation (*Blue Chip Stamps* v. *Manor Drug Stores, supra*); has set high standards of culpability for persons charged with fraud (*Ernst & Ernst* v. *Hochfelder, supra*); has established an objective standard of materiality (*TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976)); and has prescribed rules that permit efficient resolution of questions of causation and damages (*Affiliated Ute Citizens* v. *United States, supra*). If, in addition to litigating these elements under Section 10(b), parties in such proceedings also were required to establish the extent to which various allegations of the complaint would support remedies under express liability provisions, then suits under Section 10(b) would be seriously encumbered and delayed.[15] This heavy burden on

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to the challenged registration statement. In cases involving a registered offering of additional shares of a previously traded security, tracing of shares purchased in the aftermarket back to the registration statement can be an extremely difficult task, since newly issued shares are quickly commingled with those previously traded. See *Barnes* v. *Osofsky*, 373 F.2d 269, 271-272 (2d Cir. 1967).

[15] Section 10(b) potentially overlaps with a substantial number of express liability provisions in the federal securities laws, including Sections 11, 12(2), and 15 of the 1933 Act, 15 U.S.C. 77k, 77*l*(2), and 77*o*, and Sections 9(e), 16(b), 18, and 20 of the 1934 Act, 15 U.S.C. 78i(e), 78p(b), 78r, and 78t. The availability of a private remedy under those provisions will be open to question in many circum-

judicial administration would serve no identifiable purpose. Protection against unwarranted imposition of liability may be obtained through faithful application of this Court's prior decisions defining the elements of a private cause of action under Section 10(b).[16]

Nor are these burdensome determinations required to avoid "nullification" of the procedural restrictions prescribed in Section 11. Permitting suit under Section 10(b) would not make a dead letter of those limitations. As we have explained, Section 10(b), unlike Section 11, imposes on the plaintiff the burden of proving scienter, causation, and damages. Thus, the procedural limitations of Section 11 remain fully applicable in those situations in which the plaintiff either cannot or chooses not to prove those elements, and elects instead to take advantage of the liberal remedy prescribed in Section 11. As the court of appeals explained (Pet. App. A-7), recognition of these fundamental differences in suits brought under Section 10(b) and Section 11 provides the "classic reconciliation" of the express and implied remedies. See *Fischman* v. *Raytheon Manufacturing Co.*, *supra*, 188

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stances. This Court has not had occasion to pass on the elements of private actions under those provisions, their applicability to various categories of persons involved in securities transactions, or the scope of defenses that may preclude recovery in diverse factual situations. Accordingly, collateral litigation over the availability of express remedies in cases filed under Section 10(b) would interject substantial uncertainty and impose a significant burden on the federal courts.

[16] In *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 736, this Court declined to permit non-purchasers to bring suit under Section 10(b). To dispense with the purchaser-seller standing requirement under Section 10(b) would extend the implied remedy far beyond express statutory remedies and create serious evidentiary difficulties. Here, by contrast, purchasers with undoubted standing have brought suit and must sustain the substantial burden of proving scienter, causation, and damages. This litigation poses no special evidentiary problems and no threat to the express remedies or any procedural limitation peculiarly applicable to them.

F.2d at 786-787, cited with approval in *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 210-211; *Wachovia Bank and Trust Co.* v. *National Student Marketing Corp.*, *supra*, 650 F.2d at 354-358.[17]

II. THE PREPONDERANCE OF THE EVIDENCE STANDARD OF PROOF APPLIES IN CIVIL ACTIONS BROUGHT UNDER THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS

The preponderance of the evidence standard, traditionally applied in civil actions,[18] is the recognized standard in actions brought under the antifraud provisions of the federal securities laws. In one of its first opinions under the federal securities laws, *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 355 (1943), this Court held that "a preponderance of the evidence" suffices to show a violation of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a). In response to an argument that the potential for criminal application of the federal securities laws compels strict construction of those laws even in civil actions, the Court held (320 U.S. at 355) that

> [w]here * * * proof is offered in a civil action, as here, a preponderance of the evidence will establish the case * * *.

In keeping with this Court's holding in *Joiner*, federal courts have applied the preponderance standard in both

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[17] The leading treatise on securities fraud directly supports our conclusion. See 1 A. Bromberg & L. Lowenfels, *supra*, § 2.4(410), at 2:187. The authors explain that "the courts have not yet changed the right of the plaintiff to use 10b-5 for fraud in a registration statement. Nor should they change that right. For a 10b-5 plaintiff must prove scienter rather than negligence. * * * This avoids 'nullification' of [the] § 11 action * * *." See also *id.* at 2:181-2:183.

[18] See *Santosky* v. *Kramer*, No. 80-5889 (Mar. 24, 1982), slip op. 8; *Addington* v. *Texas*, 441 U.S. 418, 423 (1979); *New York Life Insurance Co.* v. *Gamer*, 303 U.S. 161, 171 (1938); *Fidelity Mutual Life Association* v. *Mettler*, 185 U.S. 308, 317 (1902).

private and government actions brought under Section 10(b).[19]

The decision of the court of appeals in this case is the only decision that deviates from the *Joiner* standard. In support of this result, Herman & MacLean relies on certain common law fraud decisions, as well as a balancing of the interests of the litigants in this case. These citations and arguments do not, however, justify use of the clear and convincing evidence standard under the federal securities laws.[20]

1. Where, as here, neither the Constitution nor any federal statute requires a heightened standard of proof, it should be presumed that Congress intended use of the traditional preponderance standard. Nothing in the legislative history of the federal securities laws suggests that Congress sought to depart from that standard. To the contrary, Congress intended to achieve the goal of investor protection by relaxing stringent standards applicable in common law fraud actions.

Congress enacted the federal securities laws to increase protection available to investors at common law. Thus, the antifraud provisions of the federal securities laws are not coextensive with common law doctrines of fraud and deceit. See III L. Loss, *Securities Regulation* 1435 (2d ed. 1961); see also *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 744-745. "A fundamental purpose, common to [the federal securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high

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[19] See, *e.g.*, *SEC* v. *Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 102 (2d Cir. 1978); *Globus* v. *Law Research Service, Inc.*, 418 F.2d 1276, 1291 (2d Cir. 1969); *Miley* v. *Oppenheimer & Co.*, 637 F.2d 318, 328 (5th Cir. 1981); *Mihara* v. *Dean Witter & Co.*, 619 F.2d 814, 824-825 (9th Cir. 1980).

[20] The points discussed below are analyzed in greater detail at pages 17-24, 26-36, and 38-40 of the Commission's brief in this Court in *Steadman* v. *SEC*, No. 79-1266, a copy of which has been served on the parties herein.

standard of business ethics in the securities industry." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963); see *United States* v. *Naftalin*, *supra*, 441 U.S. at 774-776. Since Congress enacted the federal securities laws for the very purpose of rectifying deficient common law protections, the most stringent standards of proof developed in common law cases do not govern. Under the securities laws, as under the antitrust laws, "Victorian common law does not define the limits of the * * * private action." *American Society of Mechanical Engineers* v. *Hydrolevel Corp.*, No. 80-1765 (May 17, 1982), slip op. 11 n.6; see also *Affiliated Ute Citizens* v. *United States*, *supra*, 406 U.S. at 151.

Reliance on common law principles also is unavailing because the better considered common law authorities approve the preponderance of the evidence standard rather than the clear and convincing evidence standard. As this Court observed in *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 194:

> There has * * * been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as [investment] advice and securities, and that, accordingly, the doctrines must be adapted to the merchandise in issue.

Thus, many state courts have declined to apply a more stringent standard of proof in cases involving allegations of fraud when securities are involved or when violations of state blue sky laws are at issue.[21]

Moreover, even outside the area of securities fraud, "[t]he policy of placing such a special burden [the clear and convincing evidence requirement] on one who claims to be the victim of fraud is debatable." *McCormick on Evidence* § 340, at 797 n.74 (2d ed. 1972). The better

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[21] See, *e.g.*, *General Electric Credit Corp.* v. *M.D. Aircraft Sales, Inc.*, 266 N.W.2d 548, 550 (S.D. 1978); *S & F Supply Co.* v. *Hunter*, 527 P.2d 217, 220-221 (Utah 1974). See also 11C H. Sowards & N. Hirsch, *Business Organizations: Blue Sky Regulation* (Pt. 2) § 6.01, at 6-4 to 6-5 (1979).

reasoned state court decisions, representing a significant number of jurisdictions, recognize that there is no sound basis for according special evidentiary benefits to those accused of fraud at the expense of those claiming to be their injured victims, and they explicitly adhere to the preponderance of the evidence standard of proof when fraud is at issue.[22]

While decisions in non-statutory fraud cases sometimes have employed a clear and convincing evidence standard, particularly when certain types of equitable relief have been sought,[23] the use of the higher standard generally rests on historical considerations that have no pertinence here. The practice of requiring a more stringent standard of proof appears to have arisen in equity proceedings in which the chancellor was requested to grant relief on claims that were unenforceable at law for failure to comply with the Statute of Frauds or the Statute of Wills, and the higher standard subsequently was applied in proceedings to set aside or alter the terms of written instruments.[24] Courts applied a higher standard of proof in such cases because they perceived a special danger of fabricated claims. See Note, *Appellate Review in the Federal Courts of Findings Requiring More than a Preponderance of the Evidence*, 60 Harv. L. Rev. 111, 112 (1946).[25]

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[22] See the cases collected in the appendix to Herman & MacLean's brief at CA-1 to CA-4, CA-16 to CA-18. See also the cases collected on pages 32-33 of the Commission's brief in this Court in *Steadman* v. *SEC*, No. 79-1266.

[23] See 9 *Wigmore on Evidence* § 2498 (Chadbourn rev. 1981).

[24] This Court has applied a similar rule to protect the integrity of formal documents. *United States* v. *American Bell Telephone Co.*, 167 U.S. 224 (1897) (suit to set aside patent); *Southern Development Co.* v. *Silva*, 125 U.S. 247 (1888) (suit to rescind a contract for the purchase of real estate).

[25] See *Ray Dodge, Inc.* v. *Moore*, 251 Ark. 1036, 1041, 479 S.W.2d 518, 521 (1972) ("Clear and convincing evidence of fraud is required to cancel or reform a solemn writing, but not to establish fraud in obtaining a contract by fraudulent misrepresentation");

Those cases shed little light on the issue here. Judicial scrutiny of the conduct of persons distributing securities to the investing public poses no danger to the sanctity of formal documents. More fundamentally, imposition of the most stringent standard of proof found in common law cases would undermine the basic purpose of the federal securities laws, which Congress enacted to protect investors inadequately protected at common law. Congress surely did not intend to distort the fact-finding process under those statutes so that persons charged with fraud would be absolved even though the fair preponderance of the evidence established their liability.

2. A proper balancing of the interests involved in this case likewise requires continued recognition of the preponderance of the evidence standard. Under the reasoning in *Addington* v. *Texas*, *supra*, 441 U.S. at 423-427, selection of the appropriate standard of proof calls for a careful balancing of the interests of the opposing litigants. While *Addington* considered the requirements of the Due Process Clause, the same balancing analysis is appropriate here. In *Addington*, where the state sought to commit the defendant to a mental institution, this Court noted that "[t]he individual should not be asked to share equally with society the risk of [factual] error when the possible injury to the individual is significantly greater than any possible harm to the state." *Id.* at 427. However, when both sides to a controversy have approximately equal interests in avoiding errors, they should "share the risk of error in roughly equal fashion" through use of the preponderance standard. *Id.* at 423.

In this case, a proper balancing of interests dictates use of the preponderance standard. The traditional pre-

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Household Finance Corp. v. *Altenberg*, 5 Ohio St.2d 190, 214 N.E.2d 667 (1966). This same rationale, *i.e.*, protection of the integrity of formal documents, is apparent in most of the instances in which Dean Wigmore finds that " 'clear and convincing proof' is commonly applied." 9 *Wigmore on Evidence* § 2498, at 424 n.13 (Chadbourn rev. 1981); see Note, *supra*, 60 Harv. L. Rev. at 112 n.7.

ponderance of the evidence standard puts both parties at roughly the same risk of error. A standard of proof more stringent than the preponderance standard protects the favored party against an erroneous decision that is adverse to him, but increases the overall likelihood of error.[26] This special measure of protection for a defendant at the cost of increased risk of error is tolerable only when the possible injury to the defendant is significantly greater than the possible harm to the plaintiff. Where, as here, the interests of the person charged with complicity in a fraudulent distribution of securities do not outweigh the interests of persons who purchased those securities—the very class of persons Congress intended to protect—there is no valid reason to impose a greater risk of error on the investors. In the present context, a preponderance of the evidence standard of proof, which asks the alleged wrongdoer "to share equally with * * * [the victims] the risk of error" (*Addington* v. *Texas*, *supra*, 441 U.S. at 427) is fair and should not be replaced by a standard that shifts the risk to the special beneficiaries of the federal statute. See *Steadman* v. *SEC*, 603 F.2d 1126, 1139 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).[27]

Reliance on inferential or circumstantial evidence to prove mental state does not, as the court of appeals believed (Pet. App. A-17 n.19), make the preponderance of the evidence standard inappropriate. In *Vance* v. *Terrazas*, 444 U.S. 252, 267 (1980), this Court upheld the preponderance standard in a case requiring proof of

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[26] See R. Winter, *The Jury And The Risk of Nonpersuasion*, 5 Law & Soc'y Rev. 335, 337 (1971): "we want the correct result as often as possible and that means that preponderance of the evidence is only 50% +. Imposing a greater disadvantage [on one party] would tend to cause more incorrect decisions than correct ones."

[27] "Thus, while private parties may be interested intensely in a civil dispute over money damages," the "preponderance of the evidence standard" is fully applicable. *Santosky* v. *Kramer*, *supra*, slip op. 8.

specific intent to relinquish citizenship. The Court noted that the plaintiff's duty to prove a state of mind element was "in itself * * * a heavy burden" that militates *in favor* of using the preponderance standard of proof. Moreover, reliance on circumstantial or inferential evidence should not require a higher standard of proof, since, as this Court has recognized, "[c]ircumstantial evidence is not only sufficient, but may also be more certain, satisfying and persuasive than direct evidence." *Michalic* v. *Cleveland Tankers, Inc.*, 364 U.S. 325, 330 (1960); see also *TSC Industries, Inc.* v. *Northway, Inc.*, *supra*, 426 U.S. at 463 n.24. In short, there is nothing unusual or improper about relying on inferences to prove state of mind in a civil proceeding. This is a commonplace inquiry in federal courts and the task traditionally is performed pursuant to the preponderance of the evidence standard of proof.[28]

The desirability of protecting the reputation of persons charged with statutory violations does not, as the court of appeals believed (Pet. App. A-17 n.19), warrant a heightened standard of proof. Herman & MacLean's general interest in protecting its reputation in a case brought under the federal securities laws is not substantially different from the interest of defendants in other civil proceedings—such as antitrust or civil rights actions—in which violations of federal statutes are alleged and in which the preponderance standard applies. Civil complaints of many kinds may affect the reputation of defendants, but that concern does not outweigh the need for statutory enforcement and protection of injured persons.

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[28] A defendant, concerned about the accuracy of the fact finder's determination of his state of mind, may tender evidence, including his own direct testimony, concerning that matter. Since the defendant possesses the best direct and circumstantial evidence on this issue, it makes little sense to impose upon the plaintiff, who already bears the heavy burden of proving state of mind, the additional burden of presenting "clear and convincing evidence."

The defendant's general interest in preserving his reputation falls far short of the constitutional rights and other extraordinary interests that this Court has surrounded with special safeguards.[29] Indeed, in *Vance* v. *Terrazas*, *supra*, 444 U.S. at 266-267, this Court held that clear and convincing evidence is not required even to support a result as harsh as expatriation. The Court in *Terrazas* explained that, while "in criminal and involuntary commitment contexts we have held that the Due Process Clause imposes requirements of proof beyond a preponderance of the evidence," expatriation proceedings "are civil in nature and do not threaten loss of liberty." 444 U.S. at 266. Likewise, the general risk to reputation resulting from a civil complaint alleging violation of a federal statute does not compel an extraordinary standard of proof.[30]

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[29] For example, the government must present clear and convincing evidence before terminating a parent-child relationship (*Santosky* v. *Kramer*, *supra*), before stripping a person of freedom and confining him indefinitely in a mental institution (*Addington* v. *Texas*, *supra*), and before forcing an alien to endure the "drastic deprivations" of deportation (*Woodby* v. *INS*, 385 U.S. 276, 285 (1966)). Those exceptional situations differ fundamentally from the situation here and highlight the impropriety of using a clear and convincing evidence standard in this case.

[30] While we believe that the preponderance of evidence standard applies in private damage actions, there is no doubt that it applies in SEC enforcement proceedings, as this Court held in *SEC* v. *C.M. Joiner Leasing Corp.*, *supra*. The public interest sought to be vindicated in governmental actions is even greater than the interest of private litigants who sue for money damages. See generally *Steadman* v. *SEC*, 450 U.S. 91 (1981).

Significantly, the Fifth Circuit, distinguishing its decision in the present case, recently held that the preponderance standard applies in Commission injunctive proceedings brought in district court. *SEC* v. *First Financial Group*, 645 F.2d 429, 434-435 (5th Cir. 1981); see also *SEC* v. *Savoy Industries, Inc.*, 587 F.2d 1149, 1168-1169 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979).

CONCLUSION

The judgment of the court of appeals should be affirmed insofar as it holds that Section 11 of the Securities Act does not restrict the availability of a remedy under Section 10(b) of the Securities Exchange Act, and it should be reversed insofar as it holds that the standard of proof in a private action under Section 10(b) is the clear and convincing evidence standard.

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Docket Sheet

NO. 81-680-CFX (Vide: 81-1076)	TITLE Herman & MacLean, Petitioner v. Ralph E. Huddleston, et al.

DOCKETED	COURT
Oct. 9, 1981	United States Court of Appeals for the Fifth Circuit

DATE	PROCEEDINGS AND ORDERS
	Counsel for Petitioner: James L. Truitt, Jack Pew, Jr
	Counsel for Respondents: Myer Feldman, Robert L. Deitz
Oct. 9, 1981	Petition for writ of certiorari filed.
Oct. 27, 1981	Order extending time to file a response to the petition until Dec. 10, 1981.
Dec. 10, 1981	Brief for the respondents in opposition filed.
Jan. 13, 1982	DISTRIBUTED. 2-19.
Mar. 10, 1982	DISTRIBUTED. 3-26.
Mar. 30, 1982	REDISTRIBUTED. 4-2.
Apr. 5, 1982	The petition for writ of certiorari is No. 81-680 is GRANTED. The peition for writ of certiorari in No. 81-1076 is GRANTED limited to Question 1 presented by the petition. The case is consolidated with 81-1076 and a total of one hour is allotted for oral argument.

Apr. 14, 1982	Order extending time to file the joint appendix and opening brief on the merits of Herman & MacLean until June 19, 1982. (Brief of Huddleston, et al. will be due July 19, 1982).
Apr. 23, 1982	Motion of Ralph E. Huddleston, et al. in No. 81-1076 for leave to enlarge question presented for review filed
Apr 27, 1982	DISTRIBUTED. 4-30. (Above motion).
May 3, 1982	The motion of Ralph E. Huddleston,et al. for leave to enlarge question presented for reivew is DENIED.
June 18, 1 82	Brief for petitioner filed. (Vide: 81-1076, respondent in vide case).
June 18, 1982	Joint appendix filed. (Vide: 81-1076).
June 18, 1982	Brief, amicus curiae, of Peat, Marwick, Mitchell & Co. filed. (Vide: 81-1076).
June 19, 1982	Brief, amicus curiae, of Securities Industry Association filed. (Vide: 81-1076).
June 21, 1982	Brief, amicus curiae, of Arthur Andersen & Co. filed.
July 16, 1982	Brief for the Securities and Exchange Commission as amicus curiae filed. (Vide: 81-1076)
	(Over)

81-680

Title

No.

DATE	PROCEEDINGS AND ORDERS
July 19, 1982	Brief of Ralph E. Huddleston and Chester E. Bradley, Jr., et al. filed. (Vide: 81-1076). (RESPONDENTS).
July 16, 1982	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed. (Also in 81-1076)
Sept. 3, 1982	CIRCULATED.
Sept. 9, 1982	The motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument is GRANTED.
Sept. 20, 1982	Motion of Arthur Andersen & Co. for leave to participate in oral argument as amicus curiae filed.
Oct. 4, 1982	The motion of Arthur Andersen & Co. for leave to participate in oral argument as amici curiae is DENIED.
Nov. 1, 1982	Reply brief of Herman & MacLean filed. (D).
Nov. 9, 1982	ARGUED.